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No. 15457

**In the United States Court of Appeals
for the Ninth Circuit**

SECURITIES AND EXCHANGE COMMISSION, APPELLANT
v.

**INSURANCE SECURITIES INCORPORATED, TRUST FUND
SPONSORED BY INSURANCE SECURITIES INCORPORATED,
ABE P. LEACH, OSSIAN E. CARR, ARTHUR J. LONER-
GAN, ROY A. HAIGHT, AND LELAND M. KAISER AS AT-
TORNEY AND PROXY FOR INVESTORS OF TRUST FUND,
APPELLEES**

**BRIEF OF SECURITIES AND EXCHANGE COMMISSION,
APPELLANT**

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APPELLEES**

**BRIEF OF SECURITIES AND EXCHANGE COMMISSION,
APPELLANT**

JURISDICTIONAL STATEMENT

The Securities and Exchange Commission ("the Commission"), appellant herein, filed its amended complaint in the United States District Court for the Northern District of California, Southern Division, pursuant to Sections 36, 42 (e) and 44 of the Investment Company Act of 1940 ("the Act"), 15 U. S. C. 80a-35, 41 (e) and 43 (R. 3-48). Appellees, defendants below, filed a motion to dismiss the amended complaint for failure to state a cause of action, and in support thereof filed nine affidavits (R. 52-88). The Commission opposed the motion and filed counter-affidavits (R. 97-140). On December 4, 1956, the

District Court dismissed the amended complaint (R. 151-152).

The Commission filed its notice of appeal on January 24, 1957, pursuant to Rule 73 (a) of the Federal Rules of Civil Procedure (R. 152-153). The jurisdiction of this Court is invoked under Section 44 of the Act, 15 U. S. C. 80a-43, and 28 U. S. C. 1291 and 1294 (1).

STATUTE AND RULE INVOLVED

The pertinent provisions of the Investment Company Act of 1940 and of Regulation X-14 are set forth in Appendix A, pp. 1a-16a, *infra*.

The Commission is charged with the responsibility of administering and enforcing the Investment Company Act of 1940. This statute was enacted by the Congress after an extensive investigation by the Commission into the structure, operation and management of investment companies. The Commission's investigation was made pursuant to Section 30 of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79dd).

The Investment Company Act provides for comprehensive regulation of investment companies. It applies to all types and classifications of investment companies, as indicated in Sections 4 and 5. Subjects to certain exemptions and exceptions, investment companies must register with the Commission pursuant to Section 8 (a). Section 9 (a) makes certain persons (including companies) ineligible to serve as directors, officers, investment advisers or principal underwriters. Section 10 regulates affiliations of di-

rectors, and imposes limitations and prohibitions upon transactions with the investment company when certain affiliations exist (pp. 37-39, *infra*). Section 17 regulates certain transactions between registered investment companies and their affiliates and principal underwriters. Section 18 includes provisions relating to the capital structure of investment companies, asset coverage for senior securities, and protective provisions for public investors.

Section 15 (a) requires that the investment advisory contract must be approved initially by a vote of the investors or their board of directors. A vote is also required for the annual renewal of the contract. The contract is non-assignable and is automatically terminated upon assignment by the investment adviser. Section 15 (b) contains substantially similar provisions with respect to the principal underwriting contract. Section 36 provides for the judicial removal of an investment adviser or principal underwriter where, in an action by the Commission, it is determined that such investment adviser or principal underwriter is guilty of "gross misconduct or gross abuse of trust" in respect of the registered investment company.

STATEMENT OF THE CASE

The Trust Fund and its management

The Trust Fund Sponsored by Insurance Securities Incorporated ("Trust Fund") was organized under California law pursuant to a Trust Agreement dated July 1, 1938. Its principal office is located in Oakland, California. It is an open-end diversified management company within the meaning of Sections 4

and 5, and it is registered as such pursuant to Section 8 (a).¹

The Trust Fund derives its capital funds from the continuous offerings to public investors of Participation Agreements. Such participations are sold either pursuant to a plan providing for a single payment of \$1,000 or more, or under a periodic payment plan with monthly minimum payments of \$10 over a 10-year period and a minimum investment of \$1,200. The payments, after a deduction of applicable charges, are invested in stocks of various insurance companies. Since the Trust Fund is an open-end company, its Participation Agreements are subject to redemption at the option of the investor upon terms specified in the Agreement. As of December 31, 1955, the net assets of the Trust Fund amounted to about \$215,000,000 (R. 5-6).

The investors in the Trust Fund have no general voting rights. The Trust Agreement provides, as required by Section 15 of the Act, that the Trust Fund's investment advisory and principal underwriting contracts must be approved annually by the board of

¹ Section 5 (a) (1) defines an "open-end company" as "a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer."

A diversified company means "a management company which meets the following requirements: At least 75 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 per centum of the value of the total assets of such management company and to not more than 10 per centum of the outstanding voting securities of such issuer." (Section 5 (b) (1).)

directors or by a vote of investors representing a majority of investment units of the Trust Fund. Under the Trust Agreement, as also required by Section 15 of the Act, an assignment of the contract to serve as investment adviser or as principal underwriter automatically terminates such contract (R. 6-7).²

The Trust Fund, like many other funds, has no officers of its own and, until some time after the filing of the Commission's complaint, it had no board of directors. Since its organization in 1938, management functions for the Trust Fund have been performed by Insurance Securities Incorporated ("ISI") (referred to by the court below as "Service Company"). ISI was organized contemporaneously with the Trust Fund, and has been its sponsor, manager, and investment adviser as well as its principal underwriter (R. 4-6). ISI has no other business (R. 5). ISI receives a "creation fee", or sales load, for the sale of Participation Agreements, in addition to annual management and advisory fees. For 1953-1955, the three-year period prior to the filing of this action, ISI's fees were (R. 6):

	1953	1954	1955
Creation fees.....	\$1,847,948	\$2,960,222	\$4,354,300
Administrative fees.....	165,432	224,452	276,724
Advisory fees.....	97,687	134,009	166,357
Other.....	710	884	1,126
Total.....	2,111,777	3,319,567	4,798,507

² Section 2 (a) (4) of the Act broadly defines the term "assignment" to include "any direct or indirect transfer * * * of a contract * * * by the assignor, or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor."

As of January 1956, ISI had outstanding 166 shares of capital stock, \$100 par value. Effective June 29, 1956, this stock was split into 166,000 shares, 10¢ par value. For convenience the transactions hereinafter described will give effect to this stock-split, except as otherwise indicated. As of June 30, 1956, ISI had total assets, per books, of \$1,127,114. Stockholders' equity was \$300,488, or \$1.81 per share (R. 7, 16-17).

Since its issuance in 1938 and thereafter, the stock of ISI has been closely held. As of January 1956, and for years prior thereto, the four individual defendants, Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan and Roy A. Haight, directors and officers of ISI, each owned 30,000 shares, or in the aggregate 72.6% of the total shares outstanding. The balance of the outstanding shares (27.4%) was owned by five other individuals (R. 7-8).

The sale of control of ISI

The Commission's amended complaint alleges that on or about February 1, 1956, Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan and Roy A. Haight (hereinafter sometimes referred to as "director-defendants"), acting either alone or in concert with others, embarked upon a plan to sell their controlling stock interest to a small group of purchasers. The sales were arranged through Kaiser & Co., an investment banker in San Francisco, California. The total shares of ISI capital stock sold to the purchasers between February and July 1956 amounted to 88,000 shares, or 53% of the total shares outstanding (R. 8):

Of these, 68,000 shares were sold by the director-defendants as follows (R. 8-9):

	Shares		Shares
Leach-----	29,000	Lonergan-----	13,000
Carr-----	13,000	Haight-----	13,000

The price paid for the stock was \$50 per share, although the net asset value of the ISI stock as of June 30, 1956, was only \$1.81 per share (R. 9). For its services, Kaiser & Co. received a beneficial interest in the stock (R. 59-61).

While the successive transactions were separate in form, it appears that the sales and purchases of the ISI stock were, as alleged in the complaint (R. 8), inter-related, and in sum constituted a transfer of control within the definition of Section 2 (a) (9) of the Act.³ The first block, sold in February 1956, amounted to 40 shares (40,000 shares after the 1,000 to 1 stock-split), or 24.09% of the outstanding ISI stock, of which the four director-defendants supplied 8 shares each (R. 56-57, 107-108). In May, 32 shares were sold, the four director-defendants supplying 5 shares each (R. 57-58, 108-109). In July, 16,000 shares (after the stock-split) were sold, all supplied by Mr. Leach (R. 59). The sales by these individual defendants thus accounted for about 40% of the outstanding ISI shares. The balance of approximately 13% was acquired from four other stockholders (R. 9, 58).

The possible sale of ISI stock was first brought to the attention of the Commission's staff in September 1955 by Mr. Elwood Murphey, a director of ISI and counsel for ISI, and Mr. William H. Bowen of Dallas, Texas,

³ Under Section 2 (a) (9), 25% or more of the voting stock of a company constitutes presumptive control.

now a director of ISI. It was represented that the proposed sale was occasioned by the contemplated retirement of Messrs. Leach and Carr, two of the defendants who held 36.4% of the ISI stock (R. 117-120). The discussion centered about the impact of Section 36 of the Act in the light of the Opinion of the Commission's General Counsel made public on May 11, 1942, which sets forth as Commission policy the construction of Section 36 now urged by the Commission in this case.* Since no definitive plan was then indicated to the staff, it was suggested that "if a definite proposal for disposition of the stock developed, inquiry should be made to the Commission as to whether the proposed program would be considered as contravening the principles set forth in the 1942 General Counsel Opinion" (R. 119).

No such inquiry was ever made, and the stock sales came to the attention of the Commission's staff on July 2, 1956, when ISI filed its preliminary proxy solicitation material with the Commission (R. 97-98), and when the sale of all but 16,000 of the ISI shares had been consummated. Some months previously the possible sale of the ISI stock had been the subject of correspondence with Mr. Leland M. Kaiser, who has since become the president and a director of ISI and a director of the Trust Fund (R. 8, 55, 128-135, 141). In his letter to a member of the Commission, dated October 3, 1955, Mr. Kaiser disagreed with the Commission's interpretation of Section 36 and suggested that in the disposition of stock control in an investment adviser it would be better if control were re-

* The Opinion is published as Investment Company Act Release No. 354 (R. 124-128).

tained "in a relatively few hands, rather than the widespread holding of such stock" (R. 131).

Shortly before the February purchases of 40 shares, Kaiser & Co. wrote to Mr. Murchison, Dallas, Texas: "It seems preferable to purchase the shares in blocks of 10 each in 4 separate, unrelated accounts, although this is not necessary." (R. 106-107, 112); and the acquisition of these shares was thus executed (R. 57, 106-107). The second block of ISI stock purchased in May from the director-defendants appears to have been acquired pursuant to a written option, dated March 27, 1956. A specimen copy of an option of the same date specifically provides that it was subject to the condition that at least 75% of the optioned shares must be distributed in such manner that no purchaser shall, as a result, "hold individually a beneficial interest in, or right to vote more than, $24\frac{3}{4}\%$ of the voting shares" of ISI (R. 110); and the contract with Mr. Leach, dated July 7, 1956, for the sale of 16,000 shares contained the same condition (R. 67). All of these commitments were duly carried out: 10,000 ISI shares were sold to each of three companies controlled by Murchison Bros., Dallas, Texas; 37,000 shares to Mr. D. D. Harrington, Amarillo, Texas; and 21,000 shares to Richardson & Bass, a partnership, Fort Worth, Texas (R. 56-59). The Richardson & Bass purchase was subsequently divided, 10,000 shares going to Mr. Bass, and 11,000 shares to Mr. Richardson (R. 59).

While majority stock control was not acquired until later, some management prerogatives were assumed with the first acquisition. A few days after the Feb-

ruary purchases, Messrs. Bowen and Kaiser were elected directors of ISI; and Mr. Kaiser was also elected vice-president (R. 37). Mr. Kaiser has since become, and still is, president and a director of ISI (R. 34, 55), and he now is also a director of the Trust Fund (R. 141). Their election as directors and officers of ISI appears to have taken place pursuant to letter agreements dated February 17, 1956, addressed by Mr. Kaiser to Messrs. Leach, Haight and Lonergan, and under which Kaiser & Co. exercised options to purchase from each of them 8 shares of ISI stock. These letters set forth several conditions upon which the options were being exercised, committing each of the sellers, as long as he was a director or stockholder of ISI, to exert his best efforts (1) to have Messrs. Kaiser and Bowen elected directors of ISI; (2) to have Mr. Kaiser employed on a part-time basis as vice-president and member of the executive committee at an annual salary of \$24,000 for a period of one and one-half years; and (3) to maintain the present dividend policy of ISI (R. 107-108). It was also provided that, for a period of three years or such other period as might be mutually agreeable, each of the sellers would vote salary increases "for only such officers or employees of the company [ISI] as do not presently occupy the four principal and highest salary positions of President, Vice-President and Treasurer, Secretary, and Vice-President of the company [ISI]" (R. 108). It seems that at that time the occupants of these positions were the four director-defendants (R. 38) and that these limitations would not be applicable to Mr. Kaiser who was elected vice-president a few days later (R. 37).

The solicitation of proxies

On July 17, 1956, shortly after the stock transactions previously described, ISI commenced the solicitation of proxies for a meeting of investors in the Trust Fund scheduled for August 15, 1956. The cost of the solicitation was paid for by ISI (R. 10-12, 21). The purpose of the meeting was to vote on several proposals formulated by ISI. Among these were the proposals for the reinstatement of the investment advisory and principal underwriting contracts between ISI and the Trust Fund (R. 28-32, 44, 46). The proxy soliciting material represented that ISI "is advised" that the "change in majority ownership" of ISI stock "may be considered an assignment" of these contracts and that such assignment may have had "the technical effect" of terminating the contracts (R. 21, 33). Investors were urged to act favorably on these and other proposals (R. 42, 46). The proxy material did not disclose the details of the transactions that led to the change in control of ISI. Nor were investors told of the net asset value of the ISI stock and the price the director-defendants were paid for their stock.

Another proposal submitted to investors in the Trust Fund was the creation of a board of directors for the Trust Fund to consist of seven members. The nominees for the board, chosen by the ISI management, were all directors of ISI, and included Messrs. Leach and Haight. It was proposed that upon election of the seven nominees, four would resign from the ISI

board (R. 25).⁶ In view of the filing of the Commission's complaint and an order of the court, as more fully described below, two other directors of ISI were substituted for Messrs. Leach and Haight. (R. 141).

The proceedings in the court below

In substance the Commission's amended complaint, filed on August 13, 1956, alleges that the payment for stock control at \$50 per share, as against net asset value of \$1.81 per share, represented no payment for any asset or assets owned by ISI; that the purchase price reflected the value of the perquisites and emoluments which ISI derives in the form of substantial fees from the Trust Fund under the investment advisory and principal underwriting contracts which under the Act are not assignable; and that the value attached to such contracts, being an asset of the Trust Fund, equitably belongs to the Trust Fund. The aggregate price for the total shares sold was approximately \$4,240,720 in excess of their net book value. For the 68,000 shares sold by the director-defendants, the excess over net asset value was about \$3,277,000. For appropriating such pecuniary advantages to their own account and benefit and for profiting from their fiduciary relationship to the Trust Fund, the director-defendants and ISI, it is alleged, are guilty of gross misconduct and gross abuse of trust within the mean-

⁶ Such resignations, we assume, were intended to meet the requirements of Section 10 (a), which provides that at least 40% of the board of a registered investment company shall consist of members who are not affiliated with the investment adviser. Under Section 2 (a) (3), the term "affiliate" includes a director.

ing of Section 36 of the Act. As a second cause of action, the complaint alleges that the proxy material sent to investors in the Trust Fund was false and misleading, as more fully discussed below.

The amended complaint sought, *inter alia*, a permanent injunction to restrain the director-defendants from serving as officers and directors of ISI and from serving and acting as directors of the proposed board of directors of the Trust Fund, and ISI from acting as investment adviser and principal underwriter of the Trust Fund; and an accounting for the monetary benefits which the director-defendants wrongfully and inequitably obtained as a consequence of the sale of their ISI stock (R. 14-15, 47-48). The complaint also sought preliminary relief, principally with respect to the use of the proxies at the meeting of the Trust Fund scheduled for August 15, 1956 (R. 14-15).

On August 14, 1956, the Commission brought on for hearing its motion for a preliminary injunction to restrain use of the proxies received from investors in the Trust Fund. On the same day, the defendants tendered in open court an undertaking to refrain, pending further order of the court, from voting the proxies in respect of the proposed reinstatement of the investment advisory and principal underwriting contracts and the proposed election of Abe P. Leach and Roy A. Haight as members of a Board of Trustees (or Board of Directors) to be created for the Trust Fund. The court below, upon stipulation of the parties, thereupon entered an Interlocutory Order, dated August 14, 1956, approving the undertaking and directing the defendants to comply therewith, and con-

tinuing the Commission's application for a preliminary injunction to September 7, 1956 (R. 48-49).

On August 24, 1956, the defendants below filed motions to dismiss each of the causes of action set forth in the Commission's amended complaint for failure to state any claim for relief. The defendants also filed nine affidavits (R. 52-88). The notice expressly states that the motions to dismiss were based on all pleadings and papers on file, including the affidavits (R. 53).⁶ These affidavits were also submitted in support of their motion to dissolve the Interlocutory Order of August 14, 1956, and in opposition to the Commission's motion for a preliminary injunction (R. 53). The Commission opposed these motions and filed counter-affidavits (R. 96-140).

On August 30, 1956, by agreement of the parties, the court below entered a Second Interlocutory Order pursuant to which the Order of August 14, 1956, was dissolved and the Commission's request for a preliminary injunction was withdrawn. This Order expressly reserved jurisdiction to grant any and all relief sought in the amended complaint, if it is finally determined that the Commission was entitled to judgment, including such relief as the Commission may be entitled with respect to the use of the proxies of investors in the Trust Fund regarding the reinstatement of the investment advisory and principal underwriting contracts. The Order further provided that, pending a final de-

⁶ A supplemental affidavit was filed by appellees on November 13, 1956 (R. 140-142).

termination in this action, the director-defendants shall not be elected or otherwise serve as members of the newly created board of directors of the Trust Fund, and shall not sell, or engage to sell, their remaining stock interests in ISI. Pending a final decision, the Order also restrained the payment of dividends on the ISI stock held directly or indirectly by the director-defendants, and any increase in the remuneration of the director-defendants, and other directors of ISI, subject to certain qualifications not here material (R. 93-95). The defendants' motions were continued to November 2, 1956, and, by a Minute Order entered on October 1, 1956, the hearing thereon was continued to November 16, 1956 (R. 95, 164).

On November 29, 1956, the court below issued its opinion granting defendants' motions to dismiss the amended complaint for failure to allege a cause of action under Section 36 of the Act (R. 142-150).⁷ The court below did not decide the question of the violation of the proxy rules as alleged in the second cause of action, since by the terms of the complaint, this cause of action was dependent upon the first (R. 150). An order was entered on December 4, 1956, dismissing the complaint and dissolving the Second Interlocutory Order of August 30, 1956 (R. 151-152). This appeal followed (R. 152-153).

SPECIFICATION OF ERRORS

In dismissing the Commission's amended complaint for failure to state a cause of action under Section 36, the court below erred because—

⁷ The opinion of the court is published at 146 F. Supp. 776.

(1) it failed to rule that, on the facts alleged, the sales were a gross abuse of trust under the fiduciary standards of Section 36 and the policy underlying Section 15;

(2) it improperly construed the voting requirements under Section 15 as a substitute for the fiduciary standards incorporated in Section 36;

(3) it did not rule that, as alleged in the amended complaint, appellees are persons subject to the sanctions prescribed in Section 36;

(4) it did not rule that, as alleged in the amended complaint, the proxy solicitation violated Rule X-14A-9 of the Commission's Proxy Rules.

SUMMARY OF ARGUMENT

It is conceded that ISI is the sponsor, manager, and investment adviser of the Trust Fund, as well as its principal underwriter; that ISI has no other business; and that the fees from the Trust Fund are the sole source of ISI's income. Since its organization in 1938, the Trust Fund has had no independent management of its own and ISI has performed all essential management functions for the Trust Fund. ISI clearly stood in a fiduciary relationship to the Trust Fund; and directors and officers, who are also controlling stockholders of ISI, stood in a like fiduciary relationship. As such, ISI and its directors and officers were under an affirmative duty to exercise their fiduciary responsibilities for the benefit of the Trust Fund and its public investors. Neither ISI nor its directors and officers could exploit their position for their personal gain. By the same token, the directors

and officers of ISI could not accomplish these same results indirectly through a sale of their controlling stock interest in ISI or otherwise.

I

(a) Section 36 authorizes the Commission to institute an action for temporary or permanent injunction to restrain for "gross misconduct or gross abuse of trust" a director, officer, investment adviser or principal underwriter of a registered investment company from continuing to act in any of these capacities. Section 36 derives its meaning from historic equitable principles which are incorporated therein and from the statutory purposes and policies of the Act.

The purpose of Section 36 and of other related provisions is to enforce fiduciary standards with respect to the management of investment companies, including their investment advisers and principal underwriters. This is one of the main themes of the Act, since, as the Congress found, investment companies, by reason of their liquidity and the marketability of their portfolio securities, had been particularly susceptible of abuse. One of the major abuses stemmed from the management contract which was not only a lucrative source of income but also an instrument of control and, as such, was the subject of indiscriminate trading by and for the benefit of management. Prior to the adoption of the Act, as the House Report states, there was "nothing to prevent irresponsible individuals and even individuals actually convicted of, or enjoined by the courts for,

ISI's fiduciary arrangements with the Trust Fund, and the selection of a successor rested exclusively with the Trust Fund and its investors under Section 15. To the extent that a purchaser was willing to pay a substantial sum for the privilege of succeeding to the contracts, those in control of ISI and in a strategic position to dictate or influence the course of the succession could not appropriate that opportunity for their own benefit. Under equitable principles "the responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation, in any dealings which may adversely affect it", and the receipt of substantial payments for the succession in this case is inconsistent with "the necessary undivided loyalty owned by the fiduciary to his principal", *Perlman v. Feldmann*, 219 F. 2d 173, 176. It is also incontestable doctrine that a fiduciary, while he may resign at will, may not accept payment from one who wishes to succeed to his position (see pp. 56-64, *infra*). We submit that all of these doctrines were incorporated by the Congress into Section 36 and should be enforced by a court when its equitable jurisdiction is invoked thereunder.

II

Though apparently assuming the fiduciary relationship between ISI and the Trust Fund, the court below concluded that the enforcement of equitable principles under Section 36, as urged herein, is neither necessary nor appropriate to eliminate the widespread abuses

that had resulted from trading in these fiduciary contracts. The court held that the Congress had provided a built-in remedy, namely, the termination of the agreements upon sale of stock control of ISI, thus leaving it to investors in the Trust Fund to determine by a majority vote whether to enter into new contracts with ISI under different control or with some other service company.

Courts of equity have never withheld relief for breach of trust merely because, by effective organization and intelligent use of their voting rights, security holders could displace a management not to their liking. On the contrary, in response to the growth of the modern corporation and its attendant complexities, courts of equity have exercised greater vigilance in the enforcement of fiduciary responsibilities, and equitable remedies have been correspondingly expanded to meet these developments. The same degree of vigilance and perception should be credited to the Congress when it directed the courts to enforce fiduciary standards under Section 36, especially since this is a regulatory statute enacted in the public interest and for the protection of investors. In such context, it has been said, "courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved," *Virginian Ry. v. System Federation No. 40*, 300 U. S. 515, 552 (1937). Under the Act, as we have noted, one of the basic purposes was to strengthen and raise the level of fiduciary standards, not to weaken or lower it.

The application of Section 36 as herein urged is fully consistent with the provisions of Section 15. In casting their vote on any proposed new agreements, investors are not called upon to approve or disapprove the sale of stock control of the investment adviser or of the principal underwriter, or to exonerate any wrongful conduct on the part of those who have sold such control. Indeed, the responsibility for invoking and enforcing Section 36 has been entrusted to the Commission and the courts, not to public investors, and that responsibility cannot be vetoed or waived by a vote or the consent of the investors. If investors cannot do so by a vote specifically solicited or procured for that purpose, it is unreasonable to read such a result into Section 15.

The Commission's interpretation of Sections 15 and 36 aids in the achievement of the legislative policy to eliminate trading in investment advisory and principal underwriting contracts. Under the interpretation of the court below, the abuses of the past may recur. Succession to these contracts may once more be put on the auction block for sale to the highest bidder for the benefit of management, and the purchasers may be tempted to pursue hazardous or doubtful policies in order to recoup as quickly as possible the substantial price they paid for stock control and the succession to the agreements.

III

Appellees argued below that, even if the transactions were wrongful under Section 36, ISI and the individual defendants were not persons subject to the sanctions thereunder. Section 36, they argued, ap-

plied only to an officer or director of an investment company, its investment adviser or its principal underwriter. They conceded, *arguendo*, that it would be wrong for ISI to sell its fiduciary position of investment adviser or principal underwriter, or for directors of the Trust Fund to do likewise with respect to their office. But, they urged, the alleged misdeeds in this case were not committed by ISI but by its directors and controlling stockholders, while the authors of the offending transactions were not directors and officers of the Trust Fund but rather of ISI. The court below, having determined that no wrongful act was committed within Section 36, did not reach this question, but it did indicate that if Section 36 were applicable, defendants would be persons within the reach of Section 36.

The policy of the Congress against trading in investment advisory and principal underwriting contracts cannot be evaded as a consequence of incorporation. Investors who invested their money in the Trust Fund did not put their faith in an abstract corporate entity but in professional managers and in the expert direction they had undertaken to furnish to the investors. If, for convenience or other reasons, the managers wished to incorporate, it was their privilege to do so. But, in exercising this privilege, they did not thereby escape from their self-assumed fiduciary obligations to the Trust Fund and its investors. Had these individuals themselves been serving as investment advisers or principal underwriters of the Trust Fund, it is conceded that they could not have sold the succession to their position without incurring

the sanctions of Section 36. They cannot avoid the statutory consequences because they committed the wrongful act indirectly. It is immaterial whether the offending transaction against the Trust Fund was committed by the ostensible or official occupants of the investment advisory or principal underwriting positions or by those who managed or dominated the investment adviser and principal underwriter.

It is familiar doctrine that liability is imposed upon a fiduciary who permits or condones activities, detrimental to the trust, committed by those employed to assist the fiduciary in managing the trust estate. In *Mosser v. Darrow*, 341 U. S. 267 (1951), the court said: "We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for benefit of others as they would have been on behalf of the trustee himself" (341 U. S. at 272). ISI has no proprietary nor indefeasible interest in its investment advisory and principal underwriting relationships to the Trust Fund. Since ISI, in its corporate capacity, may not sell its fiduciary position, its directors and officers cannot sell ISI's fiduciary office for their own benefit as majority stockholders. From the point of view of the Trust Fund and its investors the dangers inherent in the trading of ISI fiduciary relationships are precisely the same, whether such trading is endorsed or undertaken by every member of the corporate body or by the controlling and managing organs of the corporation.

The Commission's position on this question is supported by the provisions of Sections 9 (a) (3) and 15.

Moreover, at the time of the sale of stock control the individual defendants were directors and officers of the Trust Fund. Section 2 (a) (12) defines the term "director" as including not only a director of a corporation but also "any person performing similar functions with respect to any organization, whether incorporated or unincorporated". In the instant case, the Trust Fund had no separate management of its own at the time, and all policy and management functions were performed on behalf of the Trust Fund by the directors and their associates on the board of ISI. They were in fact the directors of the Trust Fund.

IV

The Commission's amended complaint alleges that in the solicitation of proxies for new contracts with the Trust Fund, Rule X-14A-9 of the Commission's Proxy Rules was violated. Rule X-14A-9 prohibits solicitation of proxies by means of proxy material which is false or misleading or which omits to state any material facts necessary to make any statement in the proxy material not false or misleading. In the instant case, it is conceded that the Commission's proxy rules were applicable to the solicitation of investors in the Trust Fund. It is not denied that the proxy material failed to disclose the price received by the individual defendants for their ISI stock, the net asset value of the ISI stock, and the pecuniary benefits the individual defendants have obtained as a consequence of their transfer of stock control. We believe

by the court in *Aldred Investment Co., v. SEC*, 151 F. 2d 254, 260 (C. A. 1, 1945), certiorari denied, 326 U. S. 795 (1946), a case which arose under Section 36. Accordingly, in construing Section 36, the court, as a court of equity, should apply the historic equitable principles to their fullest extent, and thus give due and proper effect to the statutory measures and policies which Section 36 was designed to impliment.

As indicated in the legislative history, the Act is "the outgrowth of a comprehensive study and investigation of investment trusts and investment companies by the Securities and Exchange Commission pursuant to the direction of the Congress."⁹ The Commission's reports covered every phase of the operations of investment companies and their management. These reports have been published by the Congress in several volumes under the title, *SEC Report on the Study of Investment Trusts and Investment Companies*.¹⁰ While the Act as finally enacted reflected a compromise on a number of measures between the Commission and the industry, there was unanimous agreement that the evils and abuses disclosed in the Commission's reports required intervention through Federal legislation in "the national public interest and the interest of investors." See Sections 1 (a) and 1 (b) of the Act.

The need for Congressional legislation was particularly emphasized because of the special characteristics of investment companies and investment trusts,

⁹ H. R. Rep. 2639 on H. R. 10065, 76th Cong., 3d Sess. (1940) 4.

¹⁰ S. Rep. 1775 on S. 4108, 76th Cong., 3d Sess. (1940) 5-6.

which were described as being "in essence institutions for the investment of the savings of small investors in securities, particularly the common stocks of industrial and other companies."¹¹ Because of their comparatively modest means, investors in securities of investment companies were generally found to be incapable of effective organization to protect their interests. In no small measure the appeal for this type of investment has rested on the overall representation that investors would fare better by entrusting their savings to the experienced and professional management of investment companies. Many trust funds have no boards of directors of their own, and their policies and operation are under the control and direction of the sponsor or one or more of the servicing agencies of the fund. Even where investment companies have their own boards of directors, effective control frequently rests in the hands of the investment manager, or underwriter company which may supply officer personnel and select the directors. In the instant case, for example, all of the management and service functions were from the very beginning performed by ISI, and the members of the newly created board of directors of the Trust Fund were nominees selected by ISI from its own board of directors.

The faith reposed by the investor in the professional management and his vulnerability to exploitation, were among the reasons that persuaded the Congress to adopt appropriate measures designed to

¹¹ H. R. Rep. 2639 on H. R. 10065, 76th Cong., 3d Sess. (1940) 6.

directors and to designate the officers, while control of the proxy machinery, combined with the natural prestige of management and aided by the apathy of investors, effectively assured the election of the sponsor's nominees. Broad exculpatory clauses were commonly inserted in the contracts, and thus minimum responsibility was joined to maximum power, a conjuncture particularly attractive to those who had ulterior designs upon the investment companies they were seeking to control. These concomitant elements of control, both tangible and intangible, gave the management contract a value far in excess of its ostensible worth, and for the benefits of such control the sponsor or management was able to exact a substantial price from the purchaser.¹⁵ Summarizing the matter in its report, the Commission stated: ¹⁶

* * * The shift in control was a private negotiation between the acquiring corporation or individual and the retiring management or sponsors of the acquired company.

Such shifts in control were usually advantageous to the retiring managers. Consequently, minority stockholders of these companies were represented in the shift of control to the acquiring individual only by sponsors and managers who may have been pecuniarily inter-

¹⁵ These and other related aspects of the problem are documented in detail in SEC Report on Investment Trusts and Investment Companies, Part III, *Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies*, pp. 1029-1031, 1078-1094, 1278-1303, 1363-1366, 1874-1875, 1876-1888, 1912, 1918-1936, hereinafter referred to as "SEC Report."

¹⁶ SEC Report, pp. 1029-1030, 1089-1090, 1920-1921.

ested in aiding, or at least not opposing, the objectives of the acquiring corporation or individual.

* * * * *

In the absence of a substantial stock interest in the company, managers of investment companies held control either because of the inertia of stockholders combined with a control of the proxy machinery or by means of long-term management contracts. To acquire control in these situations, the acquiring company purchased the management contracts at attractive prices. These management contracts usually had been taken by the sponsors of investment companies prior to the public sale of the company's securities. They were solely the result of self-dealing upon the part of the sponsors. Usually the compensation provided for in these contracts was an annual fixed percentage of the corporate assets, so that the managers were assured of revenue whether or not the company's operations were successful.

* * * * *

* * * Like voting trusts, management contracts can create control without the necessity for any financial stake in the enterprise by the managers and serve as a means of discouraging others who might attempt to acquire sufficient voting stock to depose sponsors who have little or no stock interest in the investment company * * * Furthermore, the management contract form of control avoids the necessity for offering to the public nonvoting stocks or voting trust certificates which, in view of the obvious disfranchisement involved, may be difficult to

sell. In addition, the period of duration and right of renewal of such contracts, are not at present regulated by statute. Finally, the standard of conduct required of the holder of the management contract can, by provisions in the contract, be set at a lower level than that which would be required by the courts of managing directors. * * *

Of 205 management investment companies analyzed, 105 had entered into management contracts at some time during the period 1927-1935 and at December 31, 1935, management contracts existed for 68 of such investment companies. These management contracts provided for a variety of management powers, duties, services, and accommodations. However, contractual limitations with reference to the services to be performed by the managers were at times minimized by the fact that persons ostensibly employed to provide advisory investment services have used loosely phrased provisions as bases upon which to assume all of the management functions. This was particularly true where the persons providing management also served as officers and directors, by reason of the difficulty of segregating their functions.

Several techniques were employed in the sale of management control. In some cases, compensation was paid for the direct assignment of the contract.¹⁷ In other cases, payment for the assignment was reflected in the premium paid in the purchase of blocks of the investment company's capital stock held by the management.¹⁸ In still others, when the manager or

¹⁷ SEC Report, pp. 1297-1298.

¹⁸ SEC Report, pp. 1929-1932, 2765-2766.

sponsor was a corporation, rather than a partnership or a sole proprietor, control of the contract was obtained by purchasing the stock of the management or service company at a substantial price, although the stock had little or no asset value apart from the contract and the incidents of control that went with it.¹⁹ Indeed, by the sale of such stock, no assignment was even necessary, since the contract merely continued in the name of the corporate manager, the formal party to the contract.²⁰ These transactions often involved other benefits and advantages, depending upon the relative bargaining positions of buyer and seller. The sponsor-manager might insist on continuing to act as broker for the investment company or its successor.²¹ In a great many cases, the directors, sponsors, or original distributors of the investment company's securities, agreed to aid in securing stockholders' approval of exchange offers proposed by the new management.²² The purchasers generally insisted upon the immediate right to nominate or designate their own directors, although to avoid the semblance of an abrupt transition, it was sometimes arranged for seriatim resignations by the old board members.²³ Where management was vested in trustees under a voting trust, compensation might be offered for the resigna-

¹⁹ SEC Report, pp. 98-101, 2767-2768.

²⁰ SEC Report on Investment Trusts and Investment Companies, *Fixed and Semifixed Investment Trusts*, p. 39.

²¹ SEC Report, pp. 1304-1306.

²² SEC Report, pp. 1299-1300.

²³ SEC Report, pp. 1877-1881.

tion of a trustee who could not otherwise be dislodged.²⁴

There is no need to dilate upon the evils and abuses involved in these practices. It is elementary that such practices are wholly at variance with the fundamental principle that management controls and prerogatives are powers in trust, and as such are not to be bought and sold in the market place as the personal effects of the individual managers. It is also evident that trading in fiduciary relationships necessarily involves conflicts of interests which are not likely to be resolved in favor of the beneficiaries. When trading is tolerated for any length of time, it attracts persons with a promotional flare though without professional qualifications, to the great detriment of investment companies, which, because of their high liquidity and the marketability of their portfolio, are "peculiarly subject to abuse."²⁵ Prior to the Act, investors who bought securities of investment companies generally had been persuaded to rely on the vaunted skill and experience of the sponsor and his associates, only to have control over their funds transferred to successors they did not choose or even know. The new management, forced to pay a substantial premium for control, might take the attitude that it "expected to make it up in management fees * * *,²⁶" or seek other compensating advantages. In

²⁴ SEC Report, pp. 1317-1318.

²⁵ *Aldred Investment Co. v. SEC*, 1951 F. 2d 254, 260 (C. A. 1, 1945), certiorari denied, 326 U. S. 795 (1946).

²⁶ Hearings before the Senate Committee on Banking and Currency on S. 3580, 76th Cong., 3d Sess. (1940), p. 883.

some cases, control was purchased solely for the purpose of looting the acquired company.²⁷

(b) Section 36 must be construed in the light of Section 15 and other provisions of the Act to impose fiduciary obligations upon the investment adviser and principal underwriter

One of the principal purposes of the Act was to make effective the fiduciary responsibilities of the investment company's management. In part, this was achieved by provisions designed to prevent or control the opportunities for self-dealing in transactions with or on behalf of the investment company. For example, under Section 10 (a) at least 40% of the board of directors of a registered investment company must consist of persons who are not officers, employees or investment advisers of the investment company or affiliates thereof.²⁸ Section 10 (b) (1) prohibits a registered investment company from employing as a regular broker a director, officer or employee, unless a majority of the board of directors is composed of persons not including such director, officer or employee; and this prohibition extends also to any other person, an affiliate of whom is such director, officer or employee. Parallel limitations are prescribed in Section 10 (b) (2) and (3) with respect

²⁷ See, for example, *Insuranshares Corp. v. Northern Fiscal Corp.*; 35 F. Supp. 22 (E. D. Pa. 1940); *Gerdes v. Reynolds*, 28 N. Y. S. 2d 622 (Sup. Ct. 1941); see also SEC Report, pp. 98-107.

²⁸ The term "affiliated person" of another person is defined in detail in Section 2 (a) (3) and includes a person who owns 5% or more of the voting securities of such other person; an officer, director, or partner; an investment adviser; and, in the case of an unincorporated investment company not having a board of directors, the depositor.

to principal underwriters and investment bankers. In the case of common law trusts or other unincorporated companies, the limitations therein prescribed are, under Section 10 (h), extended to the investment adviser and depositor. In the case of an open-end investment company, if all but one of the members of the board of directors are affiliated persons of the investment adviser, the contract with the investment adviser must include the specific restrictions and limitations prescribed in Section 10 (d). Under Section 2 (a) (3), an investment adviser is an affiliate of the investment company, and, accordingly, certain transactions between them are subject to Commission scrutiny and review under Section 17 (b). The provisions of Section 17 (b) apply also to such transactions between a registered investment company and its principal underwriter.

Other provisions of the Act are cast in terms which emphasize broader standards of integrity and management's fiduciary responsibilities. Such, for example, is Section 17 (i), which provides that investment advisers and principal underwriters cannot be relieved of liability for "willful misfeasance, bad faith or gross negligence" in the performance of their contracts or for "reckless disregard" of their duties thereunder. Such, too, are the provisions of Section 9 (a). Under Section 9 (a) (1) a person is barred and disqualified from acting as an officer, director, or investment adviser for "reckless disregard" of their duties thereunder. underwriter for a registered open-end company, if within ten years he has been convicted of a crime involving the purchase and sale of securities. The same

disabilities are imposed under Section 9 (a) (2) upon any person "who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment adviser * * *." Under Section 25 (c) a court, in a suit by the Commission, may enjoin consummation of a plan of reorganization with respect to a registered company, if the court finds that the plan involves "gross misconduct or gross abuse of trust" on the part of the company's officers, directors, investment advisers or other sponsors of the plan. As noted above, Section 36 gives a more comprehensive range to the management's fiduciary status, and provides for the removal of any officer, director, investment adviser or principal underwriter for any act or transaction which the court determines to constitute "gross misconduct or gross abuse of trust" with respect to the registered investment company.

Particularly germane in the latter connection are the provisions of Section 15, which are specifically concerned with the investment advisory and principal underwriting agreements—their approval, their duration, their renewal and termination, and their non-assignability. Section 15 (a), which deals with investment advisory contracts executed after March 15, 1940, provides in pertinent part: ²⁹

²⁹ Under Section 15 (d), an investment advisory contract in effect prior to March 15, 1940, may continue for a maximum of five years unless sooner terminated by assignment or otherwise, and a new contract is executed in accordance with the statutory provisions. After March 15, 1945, such contracts must conform to the requirements of Section 15.

* * * it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, * * * has been approved by the vote of a majority of the outstanding voting securities of such registered company and—* * *

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser.

Under this provision, the investment advisory contract is no longer regarded as a private arrangement to be dictated by the sponsor or promoter; nor are long-term contracts permitted. The contract, either initially or after termination of a prior contract, must be approved by a majority vote of the outstanding securities of the investment company, and it may not continue in effect for more than two years unless annually renewed by such majority, or by the board of directors, if any. When it is renewed by the board

of directors, the renewal requires, reading Section 15 (a) (2) with Section 15 (c), a majority vote of the directors who are not the investment advisers and as such parties to the contract, or affiliated persons of any such party; otherwise it can be renewed only by a vote of security holders. Under subsection (3) the investment advisory agreement may be terminated without penalty on sixty days' notice to the investment adviser; and subsection (4) provides that the agreement is automatically terminated "in the event of its assignment by the investment adviser."

Section 15 (b) contains substantially similar provisions with respect to the principal underwriting agreement. It provides in pertinent part:³⁰

* * * it shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract * * *

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment by such underwriter.

The initial or the new agreement with the principal underwriter must be approved either by the board of

³⁰ Section 15 (d), note 29, *supra*, applies also to the principal underwriting contract.

directors of the investment company or by a vote of the outstanding securities of the investment company in accordance with the conditions prescribed in Section 15 (c). Annual renewals thereof, as provided in subsection (1), call for the same procedures as those prescribed with respect to the investment advisory agreement under Section 15 (a) (2); and the principal underwriting agreement is automatically terminated upon its assignment.³¹

It should be noted that the term "assignment" in Sections 15 (a) (4) and 15 (b) (2) is not to be taken in its ordinary or more obvious meaning. In its statutory context, as defined in Section 2 (a) (4), it has a broader meaning. It includes any "direct or indirect" transfer. Also included is an "hypothecation" of the contract, for the reason that, when such contract is pledged, the character of its performance might be influenced by the investment adviser's or principal underwriter's commitments to the pledgee instead of solely by his fiduciary obligations to the investment company. It includes also transactions

³¹ It is not disputed that, as alleged in the complaint (R. 6-7), the principal underwriting and investment advisory contracts between ISI and the Trust Fund are subject to Section 15. Though initiated about 1938, they have long since been amended to conform with the provisions of Section 15. Since the Trust Fund has had no management of its own, annual renewals of these agreements have been submitted to a vote of investors in the Trust Fund. With the creation of a board of directors for the Trust Fund in September 1956, annual renewals under Section 15 may now be approved by the board of directors (R. 26). It was on the assumption, though not conceded, that the sale of the ISI stock had terminated these agreements that ISI solicited proxies of the investors in the Trust Fund and urged approval of new contracts (R. 21).

that conventionally would not be considered as involving a sale or transfer. An assignment is deemed to take place even when the critical event is an act of God. For Section 2 (a) (4) excludes from the definition "an assignment of partnership interests incidental to the death * * * of a minority of the members of the partnership having only a minority interest in the partnership business." By necessary implication an "assignment" of the investment advisory and principal underwriting contracts takes place upon the death of a partner or partners having a majority interest in the partnership. The underlying assumption is that in the latter circumstances a realignment in majority control of the members constituting the partnership may substantially affect the advisory or underwriting services rendered by the partnership. The same statutory consequences follow on the withdrawal of a partner or on the admission of a new partner.

The contingency that the investment adviser or principal underwriter may be a corporation is likewise provided for in Section 2 (a) (4). The Congress fully understood that, as disclosed in the Commission's investigation, sponsors and their allies might incorporate their professional talents and render their services to the investment company as agents or officers of the corporation to be engaged as the principal underwriter or investment adviser. Under such circumstances, actual management of the investment company could be effectively transferred by selling stock control of the corporate investment adviser or principal underwriter, without

the formality of an assignment of the underlying contract. To obviate this transparent device and disregarding, in effect, the separate corporate entity, Congress in Section 2 (a) (4) also defined as an assignment "any direct or indirect transfer * * * of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor." So defined, and as the court below stated (R. 146), the sale of a controlling block of ISI stock by stockholders of ISI constitutes an assignment of the Trust Fund's investment advisory and underwriting agreements with ISI, even though in form the sale of the stock involved no dealing with or by ISI itself or the Trust Fund, and such sale terminates these agreements.

Section 15, as viewed in terms of Section 2 (a) (4), represents a Congressional determination that the investment adviser and principal underwriter each occupies a fiduciary office in respect of the investment company; that his contractual agreement with the company constitutes an undertaking of a fiduciary character; and that its purported sale or transfer, in whatever guise or form, is wholly inconsistent with this fiduciary undertaking. As was stated in explanation of Section 15:

Here you have a situation where a person assumes a fiduciary obligation; he is the manager of other people's money. If he is through with the job, he ought to go home. However, instead of that they take these 10-year contracts which they have the right to assign to someone else.

This provision says that the management contract is personal, that it cannot be assigned, and that you cannot turn over the management of other people's money to someone else.³²

(c) The decision of the court below is contrary to the policy of the Act and equitable principles embodied in Section 36

In its amended complaint, the Commission alleges that the ISI stock was sold at \$50 per share, or at an aggregate price of \$4,400,000 for 88,000 shares, although its asset value was only \$1.81 per share (R. 9). It is further alleged that the price paid by the purchasers did "not represent the real and actual value" of the ISI shares; that it "represented no payment for any asset or assets owned" by ISI; and that it "reflected the value of the perquisites and emoluments" which ISI derives from its agreements with the Trust Fund, which agreements, being nonassignable, are not disposable assets of ISI (R. 9-10). In substance, the Commission views the transaction as only nominally a sale of stock. The unique and substantial "asset", for which the purchasers paid about \$4,000,000, is the succession to ISI's contractual and fiduciary arrangements with the Trust Fund, which ISI and the director-defendants cannot sell either directly or in the guise of a premium on ISI stock.

The court below did not make any determination as to the value of the ISI stock, nor apparently did it deem it necessary to do so. Viewing the transaction merely as a sale of ISI stock and no more, the court below concluded that no breach of trust within the meaning of Section 36 was, or indeed, could have been

³² Hearings before the Senate Committee on Banking and Currency on S. 3580, 76th Cong., 3d Sess. (1940), p. 253.

committed. The court held that Section 36 had reference to acts of misconduct relating "to obligations respecting the Trust Fund itself" (R. 148), and that the transactions in the ISI stock did not involve assets of the Trust Fund or relate to the management of its affairs (R. 147).

We submit that the Commission's construction of the transactions is more realistic. Since the net asset value of the ISI stock was only about 3.6% of the purchase price, the purchasers were obviously not buying merely a proportionate interest in the tangible assets of ISI. Further, since from the time of their contemporaneous organization, ISI has been engaged exclusively in servicing and managing the Trust Fund, it is equally clear that the purchasers were not seeking control of ISI for the purpose of undertaking other and untried ventures. The principal object of the sale necessarily was ISI's strategic position with respect to the Trust Fund, the control of which would assure the purchasers the continued benefits of the investment advisory and principal underwriting arrangements with the Trust Fund. Insofar as there may be any genuine issue as to the real character of the stock transactions, or if appellees may want to urge that the stock as such was worth substantially close to \$50 per share, the Commission is entitled to have these issues resolved by a trial on the merits. Surely, they are not susceptible of summary disposition on motion. See *Sartor v. Arkansas Natural Gas Corp.*, 321 U. S. 620, 628-629 (1944). Indeed, if this Court agrees with the Commission that, as a matter of law, the sale of the

ISI stock must be limited to a price which accords no value to the appurtenance of control and ISI's strategic position with respect to the Trust Fund, appellees, as fiduciaries, have the burden of proving that \$50 per share was that price. *Perlman v. Feldmann*, 219 F. 2d 173, 178 (C. A. 2, 1955), certiorari denied, 349 U. S. 952 (1955).

That the character of the transaction should be considered in all of its factual dimensions is clearly indicated by *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E. D. Pa., 1940). This case involved a suit by an investment company against its former directors, officers and certain stockholders who had sold stock control at a substantial premium to purchasers who subsequently looted the company. The court held the defendants liable for breach of trust. In response to the preliminary contention that no wrongful act against the company had been committed because the defendants' dealings with the purchasers had involved only a sale of stock, the court stated (35 F. Supp. at 24) :

The defendants have insisted throughout the case that the transfer of December 21, 1937, was simply a sale of stock, the passing of control being merely a normal concomitant, and most of their argument was based upon this premise. This view, however, I think is fundamentally wrong. If the whole record be read, I do not see how the transaction can be considered as anything other than a sale of control, to which the stock sale was requisite, but nevertheless a secondary matter * * *. The buyers were primarily interested in getting

control of the corporation together with such stock ownership as would make that control secure and untrammelled, and the sellers were primarily interested in getting as much money as possible for what they had to sell—both the control and their interest in the assets.

Likewise, in *Benson v. Braun*, 286 App. Div. 1098, 145 N. Y. S. 2d 711 (2d Dep't 1955), the appellate court sustained the sufficiency of a complaint which charged that fiduciaries had sold control by the sale of stock at a price far in excess of its fair value "on the theory that the said excess was paid for the resignations, for the election of the purchasers' nominees, and for immediate control of the corporation."³³

The court below in this case also construed much too narrowly the applicable fiduciary standards. Under equitable principles, "the responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation, in any dealings which may adversely affect it", *Perlman v. Feldmann*, 219 F. 2d at 176. Since, as we urge, the director-defendants here were offered and paid \$50 per share for their strategic position to dictate or influence the succession to the investment advisory and principal underwriting arrangements with the Trust Fund, they, as directors and officers and majority stockholders of ISI, could not exploit such position for their own account and benefit.

³³ On remand, the court, after trial, held that the plaintiffs had failed to prove the allegations in the complaint. *Benson v. Braun*, 155 N. Y. S. 2d 622 (Sup. Ct. 1956).

Under Section 15, the privilege of choosing a successor adviser or underwriter rests with the Trust Fund and its investors. If, as in this case, purchasers were willing to pay substantial sums for the opportunity to succeed to the management contracts, those in control of ISI could not appropriate that opportunity for themselves, but, as fiduciaries, must exercise it for the benefit of the investors in the Trust Fund.³⁴ The appropriation of that advantage for their own account did "not betoken the necessary undivided loyalty owed by the fiduciary to his principal", *Perlman v. Feldmann*, 219 F. 2d at 176.

In ruling that the sale of control of ISI did not involve a transaction "in respect of" the Trust Fund, the court below overlooked that under Section 15 and Section 2 (a) (4), the sale of stock control of ISI is regarded as a transaction in the underlying contracts as well. The court below also failed to take into account the organic relationship subsisting between the investment company and its investment adviser. The very close link between them is no mere historical fortuity. Nor is it sufficient to say that the advisory service is merely important to the investment company. It is, in fact, essential. A management investment company is more than an inert aggregate of portfolio securities. It requires a management, and those who are persuaded to buy investment company

³⁴ *Cf. Irving Trust Co. v. Deutsch*, 73 F. 2d 121 (C. A. 2, 1934), certiorari denied, 294 U. S. 708 (1935), holding that directors, as fiduciaries, may not intercept or appropriate for their own account a transaction which should be available for the benefit of the corporation.

trust, or registered face-amount certificate company.” The securities of a unit investment trust, like those of an open-end company, are by their terms redeemable,³⁸ while certificates of a registered face-amount company are required to provide for a cash surrender value, a right akin to redemption.³⁹

The placing of the investment adviser and principal underwriter within the echelon of management should not be viewed as a suggestion that they are thereby denied all autonomy in their affairs. For each, within the general domain of its own organization, there may be functions and tasks that, as the court below intimates, lie “within the area of its own independent affairs” (R. 147). But matters that concern its fiduciary responsibilities to the investment company or that may affect the character of the latter’s operations or obligations to its public investors cannot be so characterized. Clearly, acts and transactions within this range of consequences transcend the limits of such autonomy. There can be no doubt that, in view of Section 15 and the equitable principles which we discuss more fully below, the sale of the agreement between the investment company and its investment adviser or principal underwriter, either directly or in the form of a sale of stock control, must likewise be beyond these limits. The contrary view adopted by the court below in this case reflects its conception that involved herein is merely a sale of stock.

While Section 10 (a) now prescribes the maximum permissible number of common directors or officers

³⁸ See Sections 4 (2) and 5 (a) (1) of the Act.

³⁹ See Section 28 (d) of the Act.

for the investment adviser and the investment company, it is clear that, subject to this and other related limitations, these affiliations, as indicated in Appendix B, *infra*, still continue, and historic origins as well as essential operational ties make such affiliations both natural and understandable.⁴⁰ Appendix B also indicates that in a substantial number of cases all of the fund officers are paid by the investment adviser and that only in a relatively few cases is this practice either not in force or limited to common officers.⁴¹ Moreover, directors of the fund frequently are nominees of the adviser or underwriter, who may also select its officers and other personnel.⁴² In the instant case the board of directors for the Trust Fund, first established since the filing of this lawsuit, consists of 7 members, all nominated by the ISI management. All of these 7 previously were members of the ISI board, and 4 resigned upon their election presumably in order to comply with the provisions of Section 10 (a). The responsibilities normally exercised by officers apparently are still discharged by ISI personnel.

Further, in Appendix C, *infra*, are listed 150 firms serving as investment advisers or principal under-

⁴⁰ See Appendix B, *infra*, for data on common affiliations with respect to investment advisers and principal underwriters for 57 registered open-end investment companies having net assets of \$25 millions or more.

As noted on page 5 thereof, the data in this Appendix are based upon public information.

⁴¹ See Appendix B, column 9.

⁴² In some cases, the fund may control the adviser or underwriter. This is not material for our analysis, which is concerned with common control or influence. The direction from which it emanates is of no consequence.

writers, or both, for open-end funds.⁴³ Like ISI, about 32% of these have no other business except servicing the open-end fund or funds therein indicated, and from sources available to us no other business is indicated for about another 25%. This makes a total of about 57% of companies which are either wholly or almost entirely engaged in servicing a particular open-end fund or funds.⁴⁴ In some cases, the investment advisers or principal underwriters are partnerships. More often, they are corporations which, with two exceptions, have relatively small amounts of stock outstanding, and their stock is closely held.⁴⁵ Aside from what appears on the balance

⁴³ As noted on p. 16 of Appendix C, the data for these firms are based on information available to the public.

⁴⁴ The remaining firms appear to be engaged in varying degrees in such related businesses as investment banking, investment counselling for individual accounts, securities brokerage, or other businesses not readily classifiable.

We take this occasion to correct an error made in the course of assembling the data for Appendix C. On page 14 of this Appendix, State Street Research & Management Corporation is listed as adviser and underwriter for State Street Investment Corporation. The service company performs only advisory service. See Appendix B, p. 1.

⁴⁵ Such data with respect to the corporate adviser or underwriter is set out in column 6 of Appendix B. To the left are the data showing, where available, the amount of shares outstanding; to the right are the figures showing their percentage distribution. For example, for United Funds, Inc., seventh in the list of open-end funds, the investment adviser, Continental Research Corp., has 8 shares outstanding, 2 stockholders holding 50% of the outstanding stock. The number "2" and the corresponding figures for the other companies do not refer to the total number of stockholders in the corporation, except where the context so requires. As previously noted, the data in Appendix B are limited to funds with net assets of \$25 millions or more.

sheets, their real income producing "asset" obviously lies in their underwriting and advisory connections with the funds. For these reasons, the stock of such corporations is not generally traded in the market, and, as in the case of ISI, significant transactions in the stock would usually involve shifts in control.

The decision by the court below will bring once again into focus the danger of trading in these fiduciary arrangements, since existing concentrations of stock control and the small amount of outstanding stock provides ready-made occasions for the sale of stock control. It is hardly likely that the significance of the investment adviser's and principal underwriter's close connections with the fund or funds will be ignored by the sellers and buyers in their negotiations for the sale of stock control. In any negotiated price in excess of net asset value, the component value attached to these fiduciary relationships will not merely be present but, as in this case, will be substantial and the most important. Although under Section 15 these contracts are terminated, no effective opposition to any new contracts with the successors, as we shall see (pp. 80-81, *infra*), is likely to develop among public investors; nor, significantly, within the fund management, some of whose influential or controlling members, as in this case, are likely to be parties to the sale.

We believe that, once the interlocking and fiduciary ties between the investment company and its adviser or underwriter are fully considered and the stock transactions are realistically appraised, there can be no dispute about the fundamental proposition that a fiduciary cannot exploit his position of trust for his

own benefit by selling his office directly, through the sale of stock control, or in any other manner. This is well-established in equity with respect to trustees, receivers, administrators, guardians, and corporate directors or officers. It has been set forth time and again, as we shall see, in the decisions of courts of equity, and has received the full endorsement of authoritative commentators.⁴⁶ It has not been thought that, for effective administration of an estate or for successful pioneering efforts in a business enterprise, the fiduciary, to whom these achievements are credited, may auction off his position on the eve of retirement as an additional reward for work well done. The same fiduciary standards are necessarily applicable under Section 36 with respect to the investment adviser and principal underwriter or their controlling persons. The declaration by the Congress in Section 15 that the investment advisory and principal underwriting agreements are not articles of commerce for trading in the market lend additional support for reading these standards into Section 36.

The fiduciary principle, as we read it in the light of the policy of the Congress and the provisions of Section 36, was announced by Vice-Chancellor Sir John Stuart one hundred years ago in *Sugden v. Crossland*.⁴⁷ In that case, a trustee under a codicil to a will retired from his office and, in consideration of £75, executed a deed appointing as his successor a person who had been named as trustee in the original

⁴⁶ Perry, *Trusts and Trustees* 712 (7th ed. 1929); 3 Cook, *Corporations* 2428 (1923).

⁴⁷ 3 Sma. & Giff. 192, 65 Eng. Rep. 620 (1856).

will. In cancelling the deed of appointment and in directing the selling trustee to account to the estate for the funds, the Vice-Chancellor said:

This is a very extraordinary case * * *
 There are cases on record in which a trustee has paid money in order to induce other people to act with him in the execution of a trust, and in which he has been allowed the money so paid. I do not remember a case where the office of a trustee has been purchased for money. * * * It is a well-settled principle that, if a trustee make a profit of his trusteeship, it shall enure to the benefit of his *cestui que trusts*. Though there is some peculiarity in the case, there does not seem to be any difference in principle whether the trustee derived the profit by means of the trust property, or from the office itself * * * ⁴⁸

The court declined to consider the mitigating suggestion that the parties, who were in an "humble station of life", were ignorant that their arrangement violated any rules of equity.

This principle has also been followed by our courts. It was clearly illustrated in *McDonald v. Forbes*, 54 Cal. 98 (1880). The defendants were dealers in the stock of a corporation managed by five trustees, of which plaintiff Forbes was one. Since there was dissension within the management, the defendants induced Forbes to resign so that "they might put some friend in his place." In consideration they agreed to secure a debt owed to Forbes by a third party. When the debt was not paid, Forbes brought suit

⁴⁸ 3 Sma. & Giff. at 193-4, 65 Eng. Rep. at 621.

against the defendants. The court held the agreement unenforceable, since an officer, although he might resign as he pleases, cannot do so for a price. The court said:

It is not necessary to cite authorities to show that a contract is void if a portion only of the consideration is illegal. It does not appear to us to be at all doubtful, that if the whole or a part of a consideration be that a trustee resign his trust, the consideration is illegal. It is *contra bonos mores*. Trustees of corporations owe duties to others besides themselves; they have been placed in a position of trust by the stockholders, and to those stockholders they must be faithful. It is a violation of that trust for them to be bought out of office. They may resign when they please, but they must not make profit or benefit themselves in the matter of such resignation.

In *McClure v. Law*, 161 N. Y. 78, 55 N. E. 388 (1899), the defendant, president of an insolvent insurance company, and some of its directors agreed to resign and to transfer control of the corporation by electing the purchaser and others to the vacancies. In consideration the purchaser paid him a sum of money to reimburse him for the payment of the corporation's notes which were not collectible. The court construed the arrangement as involving a payment for the election of the purchaser and his associates as directors and for the control and management of the corporation. Although it appears from the opinion of the lower court that the purchaser, subsequent to his election, looted the company, the appellate court did not

rely upon these circumstances but held the defendant liable for the sale of his fiduciary office. It held that as president and director he was liable to the corporation

for all moneys that came into his hands by virtue of his official acts * * * The election of directors, and the transfer of the management and property of the corporation, were official acts, and whatever money he received from such official acts were moneys derived by virtue of his office, for which we think he should account.

The court analogized the case before it to that of a trustee who "retired from the office in consideration that his successor paid him a sum of money."

The same principle was applied in *Moulton v. Field*, 179 Fed. 673 (C. A. 7, 1910), in connection with the sale of a management contract. In that case, Gray, who had organized Western Indemnity Company, obtained a 25-year contract which gave him sole control and management of the company, including control of the proxy machinery. His annual salary was \$12,000. Subsequently, when he became seriously ill, and his contract had four years to run, Gray offered to sell his contract for \$125,000 to Rosenfeld, who was willing to pay if he could become general manager. Moulton, president of Western, was persuaded to join in the scheme on Rosenfeld's promise that when he became general manager, he would increase Moulton's salary and would turn over to Western the business of another insurance company for \$200,000. It was understood that out of this amount Rosenfeld would pay Gray \$125,000 and pocket the difference. It later appeared that the assets turned

over by Rosenfeld were worthless. The court affirmed a judgment against Moulton for the full \$200,000, on the theory that if the succession to Gray's general management contract was worth \$125,000, the sale (if lawful) should have been made for the benefit of Western. The court said (179 Fed. at 675):

With this proxy control in Gray's hands, the directors came to regard Gray, and not the owners, as the master of the business. When Gray became incapacitated, his employment should have been ended on that account; and in all probabilities would have been, if the directors had considered themselves servants of the policy holders instead of dependents of Gray. If the succession was worth \$125,000 in the market, the sale (if it were lawful) should have been made by the directors for the benefit of the owners of the business, not of Gray. For Gray had nothing legally saleable. His contract, being for personal service, was not assignable; and the resolution of the directors really created a new contract with Rosenfeld (the purchaser). So the arrangement * * * by which the office of general manager and the proxy control were sold to Rosenfeld and the consideration turned over to Gray instead of into the treasury, was a betrayal of trust.

Likewise in *Sherman & Ellis v. Indiana Mutual Casualty Co.*, 41 F. 2d 585 (C. A. 7, 1930), in a suit to enforce a contract to permit a management company to manage the affairs of a casualty company for a period of twenty years and to appoint its underwriting manager and its "executive head," the court held that, since management responsibilities were nonas-

signable, the contract was void as against public policy.⁴⁹

Courts of equity have enforced the same principle when the fiduciary or corporate office has been sold as part of a package which formally appeared as a sale of stock control. Looking at the substance of the matter, the courts would not accept the surface form of the transaction.⁵⁰ The ingredients of the sale have been thoroughly sifted in order to determine how much of the purchase price might be legitimately attributed to the investment value of the stock. Directors or officers have been held liable for breach of trust when, upon the evidence, it appeared that the excess "was not so much a part of the price paid for the stock owned or controlled by the defendants as a secret consideration paid to them for the purpose of gaining immediate control of the organization of their corporation", *Porter v. Healy*, 244 Pa. 427, 91 Atl. 428 (1930).

The immediate issue in *Bosworth v. Allen*, 168 N. Y.

⁴⁹ *Cf. West v. Camden*, 135 U. S. 507 (1890), in which the court held a contract by a director to keep another permanently in place as an officer of the corporation, void as against public policy. The court said that the rule was analogous to that applicable "to the case of a public office." 135 U. S. at 520.

⁵⁰ The problems relating to the sale of stock control have been the subject of considerable discussion in the legal literature, though not with particular reference to the statute in this case and its underlying policy. See Jennings, *Trading in Corporate Control*, 44 Calif. L. Rev. 1 (1956); Leech, *Transactions in Corporate Control*, 104 Penn. L. Rev. 725 (1956); Hill, *The Sale of Controlling Shares*, 70 Harv. L. Rev. 986 (1957); *Comments*: 54 Mich. L. Rev. 399 (1956); 22 U. of Chi. L. Rev. 895 (1955); 40 Cornell L. Q. 786 (1955); 68 Harv. L. Rev. 1274 (1955); 40 Va. L. Rev. 195 (1954); 19 U. Chi. L. Rev. 869 (1952).

157, 61 N. E. 163 (1901), was a procedural point on alleged misjoinder of two causes of action, but the substantive principles, in terms of which the issue was resolved, makes this decision pertinent here. There recovery was sought on the theory that the excess value of the shares was paid for the resignation of the directors and on the ground that the defendants were liable in tort for transferring control to irresponsible persons who mismanaged the company. The court reversed the lower court, which had dismissed the action for improper joinder of two causes of action, and held that in an action for an accounting the plaintiff was entitled to relief on both grounds. The court said that if directors of a corporation

are treacherous to its interests, and appropriate its property, or intentionally waste its assets, or take money for official action, or "sell out" by resigning, and thus giving control to others, they are liable to account in equity to the corporation or its representatives, not only for the money or property in their hands, but also for such as they fraudulently disposed of or wasted, as well as for the damages naturally resulting from their official misconduct; and even, as we have recently held, for money received by virtue of their office. *McClure v. Law*, 161 N. Y. 78, 55 N. E. 388.

Perlman v. Feldmann, 219 F. 2d 173 (C. A. 2, 1955), certiorari denied, 349 U. S. 952 (1955), carried this approach one step beyond. In that case, a 37% block of shares of Newport Steel Corporation was sold by Feldmann and members of his family. Feldmann was president, chairman of the board and a dominant

stockholder. The sales price was \$20 per share although the book value was \$17 and in recent sales in the over-the-counter market the price had not exceeded \$12 per share. The purchasers were end-users of steel. Pursuant to the agreement of sale, all members of the board of directors resigned immediately after the sale, and the purchasers' nominees were elected in their stead. Although no damage to the corporation was established, the court held the defendants liable to the plaintiff shareholders. The court stressed that the sale occurred during the Korean crisis when steel was in short supply, and that the purchasers' willingness to pay \$20 per share reflected in part a premium paid for the power to control the distribution of the corporate product. It accordingly remanded the case to the district court for an accounting of that portion of the excess of \$12 per share which reflected the value attached to this managerial prerogative, which, in the court's view, did not belong to the defendants but to the corporation and its shareholders.^{50a}

Young v. Higbee Co., 324 U. S. 204 (1945), also provides an excellent illustration of the vitality and flexibility of the doctrine. In that case, Potts and Boag, preferred stockholders, were not officers or directors of the company, nor even dominant shareholders, and their fiduciary status was based merely upon their commanding position in a lawsuit which they themselves had initiated. These stockholders appealed from an order confirming a plan of re-

^{50a} In its decision of July 18, 1957, the district court held the defendants liable in the aggregate amount of about \$1.3 millions. *Perlman v. Feldmann*, D. C. Conn., Civil Action No. 3086.

organization under Chapter X of the Bankruptcy Act, urging that the plan was not fair and equitable because it did not subordinate certain prior debt claims to the preferred stock. During the pendency of the appeal, two debt claimants purchased the stock from Potts and Boag on condition that they dismiss the appeal. At the time, the market value of their preferred stock was \$17,000, for which they received \$115,000. The court held that, having appealed on a matter which concerned the entire class of preferred stockholders, they had assumed a fiduciary responsibility to other members of the class, and could not use their statutory right to be heard in the proceedings and to appeal as a means for obtaining personal gain. Since the price they received was not for the stock alone, they were held accountable to the other stockholders for the difference between the sales price of their stock and its market value, even though the district court had rejected their objections to the plan, and there was no indication that they would have succeeded had they prosecuted the appeal.⁵¹ See also *Clarke v. Greenberg*, 296 N. Y. 146, 71 N. E. 2d 443 (1947).

It should be noted that in cases such as *Perlman v. Feldmann*, *supra*, a substantial or a predominant portion of the price represented the investment value of the stock in a going enterprise. The breach of trust was predicated upon a determination that the excess over investment value was paid for the surrender of the corporate office or other managerial prerogative,

⁵¹ For the proceedings on remand, see *Potts v. Young*, 161 F. 2d 597 (C. A. 6, 1947).

and accountability was accordingly limited to this portion of the purchase price. Since valuation techniques are not exact and yield only approximations, the determination of the proscribed component may occasionally be complicated in terms of proof. In a close case, therefore, if the two components of the price are not quite apparent, the courts, as a practical matter, will deny recovery. In these circumstances, the transaction will be regarded essentially as a sale of stock, although if a *prima facie* case is established, the burden of explanation is cast upon the fiduciary.⁵²

When the transaction involves the sale of the office or the management contract alone, unaccompanied by a sale of stock, these complexities are not present. Then the very act of sale constitutes the breach of trust and the purchase price itself is the measure of the fiduciary's liability.⁵³ The same, to a very large degree, is equally true in the sale of a controlling stock interest in investment advisory or principal underwriting companies such as ISI which, as we have seen, often have no other significant business. Since such companies are principally or exclusively engaged in fiduciary undertakings, the substantial element in the price for the stock will represent payment for the succession to these undertakings. The assets of these

⁵² See *Perlman v. Feldmann*, 219 F. 2d 173, 178 (C. A. 2, 1955), certiorari denied, 349 U. S. 952 (1955). It may be noted that Judge Swan, dissenting in this case, felt bound by the district court's findings that as a control block the stock of Newport Steel was worth \$20 per share and that there was no evidence as to its value "if shorn of its appurtenant power to control distribution of the corporate product" (219 F. 2d at 179-180, fn. 1).

⁵³ See *Sugden v. Crossland*, and *Moulton v. Field*, discussed pp. 56-57, 59-60, *supra*.

companies, which may be regarded as freely and legitimately transferrable, are likely to be balance sheet items that are relatively small in relation to the total purchase price. In the instant case, the price allocable to the value of the stock was relatively insignificant. By far the largest element in the price, as alleged in the complaint, represented payment for ISI's controlling position with respect to the Trust Fund.⁵⁴

There is no need to emphasize that the conceptions of fiduciary duty and remedy exemplified in these cases were not created by statute. They were developed by courts of equity as instruments of public policy in order to prevent corrosion of the fiduciary responsibilities of those who have undertaken to manage money or property of others or to act on their behalf. The public policy expressed by the Congress under the Act is both emphatic and inclusive. It states in effect not only that the fiduciary arrangements between an investment company and its investment adviser or principal underwriter are not assignable but also that in the event of an assignment, the fiduciary relationships themselves are automatically terminated. This policy is buttressed by the broad definition of "assignment" under Section 2 (a) (4)

⁵⁴ In the instant case net asset value of the ISI stock was \$1.81 per share against the purchase price of \$50 per share. Cf. *Perlman v. Feldmann*, *supra*, in which the book value of the Newport Steel stock was \$17 per share as against the purchase price of \$20.

Cf. *Young v. Higbee Co.*, 324 U. S. 204 (1945), discussed p. 63, *supra*, where, since the stock was purchased not for its investment value but for the surrender by the sellers of their strategic position in the reorganization, the purchase price was \$115,000 as against a value of \$17,000.

in order to encompass transactions which otherwise might not have been reached under Section 15 alone. It has been said that "in the increasing complexities of modern business relations equitable remedies have necessarily and steadily been expanded, and no inflexible rule has been permitted to circumscribe them."⁵⁵ The same sense of accommodation should prevail in the interpretation of Section 36, especially since the matter in issue arises under a regulatory statute enacted by the Congress for the protection of investors and in the public interest, lest a grudging enforcement of the statute mark the beginning of its frustration. As the court said in *Virginian Ry. v. System Federation No. 40*, 300 U. S. 515, 552 (1937): "Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved."

Provisions of a statute should be so construed as "to carry out in particular cases the generally expressed legislative policy", *SEC v. Joiner Leasing Corp.*, 320 U. S. 344, 350-51 (1943), and the Congress has expressly indicated that it be done under this Act. For example, Section 6 (c) authorizes the Commission to exempt any person or transaction from the provisions of the Act to the extent that such exemption, *inter alia*, is consistent with "the purposes fairly intended by the policy and provisions" of the Act. Section 17 (b) provides that on application the Commission may exempt transactions between a registered invest-

⁵⁵ *Union Pacific Railway Co. v. Chicago, etc., Railway Co.*, 163 U. S. 564, 600-601 (1895).

ment company and its affiliates on the basis of findings, among others, that "the proposed transaction is consistent with the general purposes" of the Act. The courts, no less than the Commission, are to be guided by this broad legislative gloss upon the Act. The task of applying the sanctions prescribed by Section 36 has been assigned to the courts, and in so doing the Congress intended, as in the case of other statutes, "to mobilize the judicial authority in carrying out the policies of the Act", *Central-Illinois Securities Corp. v. SEC*, 338 U. S. 96, 125 (1949). As already noted, the last sentence of Section 1 (b) expressly provides that *all* provisions of the Act be interpreted in accordance with "the policy and purposes" thereof.

II. The voting provisions of Section 15 were not intended by Congress as a substitute for the broad equitable standards under Section 36 and the sanctions therein prescribed

Though apparently assuming the fiduciary relationships between ISI and the Trust Fund, the court below states that "the Congress did not make the assignment of agreements between Service Company [ISI] and Trust Fund, a violation of the Act, thus subjecting the violator to any and all of the sanctions provided by the Act" (R. 148). But we are not urging that every transaction that is legally deemed an "assignment" is wrongful or a breach of trust under Section 36. A sale of a controlling stock interest in the corporate investment adviser or principal underwriter at net asset value, or a transfer of such control by gift without more, is proper, even though the advisory or underwriting agreement is thereby termi-

nated under Section 15. Likewise, the death of a partner having a majority interest in a partnership which renders investment advisory or underwriting services to an investment company terminates the contract automatically, even though no sale or transfer of the contract literally occurs. It is when the sale of control involves receipt of consideration for the succession to these fiduciary offices that in our view, the sale constitutes "gross misconduct" or "gross abuse of trust" under Section 36. Nor are we urging that "all" of the statutory sanctions be applied here, since actions under Section 36 are specifically limited to the civil remedies there prescribed. Whether or not the Congress intended "any" judicial sanctions, is, of course, the central question in the case.

It seems that the lower court's observations were merely preliminary to its affirmative ruling that Section 15 itself prescribed its own "specific remedy", namely, that the sale of stock control automatically terminates these agreements, "thus leaving it to investors of Trust Fund" to determine by a majority vote whether to enter into new agreements with ISI under different control or with some other service company (R. 149). We agree that such is the effect of Section 15. But we do not agree with the implications. The court interprets Section 15 as though it read in effect that an assignment or sale is proper if a majority of the investors approve it. This implies that the Congress, faced with the wide-spread abuses resulting from trading in management contracts, determined that, to deter their recurrence, the enforcement of

fiduciary standards under Section 36 was neither necessary nor appropriate.

Section 15, as we have seen, does not make the assignment of investment advisory and principal underwriting agreements conditional on approval by the prescribed statutory vote.⁵⁶ The regulatory pattern is quite different and the underlying policy more strict. Sections 15 (a) (4) and 15 (b) (2) state respectively that it is unlawful to render investment advisory and principal underwriting services except pursuant to a written contract which must provide that they shall terminate "automatically" in the event of their assignment. Existing contracts, therefore, cannot be assigned with or without approval of investors. If they are assigned, not only is the assignment ineffectual but the underlying contractual arrangements for these services are thereby terminated. Pending the execution of new contracts and their approval by the vote required under Section 15, it is unlawful to perform these services except pursuant to an exemption (see pp. 78-79, *infra*).

There is no basis for assuming that the Congress intended Section 15 to preempt this vital and sensitive area of regulation to the exclusion of Section 36. While Sections 15 and 36 both assume the fiduciary status of the investment adviser and the principal underwriter, they are concerned with different, though related, aspects of that relationship. When

⁵⁶ We do not, however, wish to imply that if the statutory provisions against assignment were so conditioned, the management could make the assignment under circumstances which would involve the sale of the fiduciary office in contravention of equitable principles. See note 60, *infra*, and accompanying text.

stock control of the investment adviser or principal underwriter is sold and the contracts are thereby terminated, statutory approval of any new contracts is required under Section 15, while Section 36 focuses attention upon the fiduciary obligations of those who sell such control. To the extent that in a particular situation they traverse common ground and may affect respectively the purchasing and selling ends of the same transaction, Sections 15 and 36 should be read not in a spirit of antagonism and exclusion but in terms of harmony and mutual support, so that the policy of the Congress against trading in advisory and underwriting contracts may be fully attained. In *United States v. Boisdore's Heirs*, 8 How. (U. S.) 113, 121 (1850), the court said: "In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy."⁵⁷ Words are even denied their literal meaning if to accept them literally would produce a result at variance with the legislative policy and purpose.⁵⁸ In this case, of course, it is sufficient that the words in the Act be given their natural meaning and intended purpose. For it is well within the bounds of literal consistency, and certainly in furtherance of the legislative purpose, to provide, on the one hand, that those seeking to assume the position of investment adviser or principal underwriter must secure the approval

⁵⁷ Quoted in *Mastro Plastic Corp. v. NLRB*, 350 U. S. 270, 285 (1955).

⁵⁸ *United States v. Rosenblum Truck Lines*, 313 U. S. 50, 55-56 (1941); *Commissioner v. Sternberger Estate*, 348 U. S. 187, 206 (1954).

required by Section 15; and, on the other hand, to prescribe that those who relinquish control shall be removed from any position of trust pursuant to Section 36, if they exploit the occasion for their self-enrichment.

Since, as we have seen, one of the basic purposes of the Act was to strengthen and raise the level of fiduciary obligations, not to weaken or lower it, Section 15 cannot be construed as a legislative writ of absolution from any of these obligations. In enacting Section 15, the Congress determined in effect that, because of their endemic relationship to the investment company, the investment adviser and the principal underwriter must be regarded in effect as members of the management complement, and that, as such, they must stand initially and annually thereafter for election by a majority vote of the investors or of their board of directors.⁵⁹ Accordingly, like directors and officers, they must assume the responsibilities essential to their fiduciary station and the restraints appropriate to their high office. Were a director of a registered investment company to engage in a transaction which involved a sale of his office, he would be subject to removal under Section 36 from any other fiduciary position therein indicated, including that of investment adviser or principal underwriter. It can hardly be contended that the result is any different if the transaction involves or is related to the office of investment adviser or principal underwriter itself. On the contrary, the wide-spread abuses disclosed in the investigation and

⁵⁹ See discussion of Section 15, pp. 39-44, *supra*.

the strong policy in Section 15 against assignment as defined in Section 2 (a) (4) require that such transactions be considered "gross misconduct" or "gross abuse of trust" under Section 36.

The construction of Section 36 as urged herein does not in any way detract from the authority conferred upon investors by Section 15. In casting their vote under Section 15 investors are not called upon to approve or disapprove the sale of the stock control, or to extenuate or to condemn any wrongful conduct in which those who sold control may have engaged. They vote only on whether to enter into a new contract with the successor persons in control. The statutory responsibility for invoking and enforcing the sanctions under Section 36 has been entrusted to the Commission and the courts, not to the investors.

The sanctions therein provided are of such central importance that the effect of an injunction under Section 36 is not limited to the particular investment company in respect of which the offense was committed. Under Section 9 (a) (2), a fiduciary enjoined under Section 36 is barred and disqualified from acting as an investment adviser, principal underwriter and in other fiduciary capacities with respect to *all* registered investment companies, unless, as provided by Section 9 (b), the Commission grants an exemption therefrom. Since the removal of a faithless fiduciary and its statutory consequences have been enacted in the public interest and for the protection of investors, these remedial provisions and the Commission's obligation thereunder cannot be vetoed or waived by a vote or the consent of investors. See *Medo Photo*

Supply Corp. v. NLRB, 321 U. S. 678, 687 (1944); *Brooklyn Savings Bank v. O'Neil*, 324 U. S. 697, 704-706, 712-713 (1945). Cf. *National Licorice Co. v. NLRB*, 309 U. S. 350, 360 (1940).⁶⁰ If investors cannot do so by a vote specifically solicited or procured for that purpose, there is even less reason for reading such a result into Section 15, which, as we have seen, does not contemplate or call for a vote of exoneration. Section 15, we submit, underscores the fiduciary position of the investment adviser and principal underwriter. It does not release them from any responsibilities and restraints imposed upon them as a consequence of their fiduciary status.

It may be noted that a similar approach and policy were expressed by the Congress in Section 25 of the Act relating to reorganizations of registered investment companies. Such reorganizations often require a vote of stockholders under local law. Solicitation

⁶⁰ In *Medo Supply Corp. v. NLRB*, 321 U. S. at 687, the court said: "The statute was enacted in the public interest for the protection of the employees' right to collective bargaining and it may not be ignored by the employer, even though the employees consent, *Labor Board v. Newport News Co.*, 308 U. S. 241, 251, or the employees suggest the conduct found to be an unfair labor practice, *National Licorice Co. v. Labor Board*, *supra*, 353, at least where the employer is in a position to secure any advantage from these practices, *H. J. Heinz Co. v. Labor Board*, 311 U. S. 514, 519-521, and cases cited."

Cf. Section 47 (a) of the Investment Company Act which provides that, "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or with any rule, regulation, or order thereunder shall be void."

Even where a statute does not have an anti-waiver provision, courts will invalidate the waiver if to permit it would thwart the legislative policy. See *Brooklyn Savings Bank v. O'Neil*, 324 U. S. 697, 713 (1945), and cases there cited.

of proxies with respect to plans of reorganization are subject to Commission scrutiny under Section 25 (a). Under Section 25 (b) the Commission is authorized to prepare an advisory report on the plan at the request of holders of 25% of any class of the outstanding securities, and the investment company is required to mail a copy of such report to all security holders affected by the plan. Nevertheless, whether or not the plan is approved by the security holders, the Commission, under Section 25 (c), may obtain an injunction against the consummation of the plan if the court determines the plan to be "grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors, or investment advisers of such registered company or other sponsors of such plan." Similarly, certain transactions between a registered company and its affiliate are prohibited under Section 17 (a) unless an exemption is obtained under Section 17 (b). The grant of the exemption is conditioned on a finding by the Commission, *inter alia*, that the proposed transaction is fair and "consistent with the general purposes" of the Act. The Commission rejected a construction which "would, in effect, make a vote of security holders a substitute for review under Section 17 (b)." *E. I. Du Pont de Nemours & Co.*, 34 SEC 530, 534 (1953).⁶¹

That the Congress did not declare in *haec verba* the

⁶¹ *Cf. Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 127-129 (1939), in which the court held that in bankruptcy reorganization, judicial authority for determining whether a plan is fair and equitable cannot be abrogated merely because a majority of the security holders affected by the plan have consented to it.

sale of the succession to the office of investment adviser or principal underwriter to constitute a breach of trust, is not significant. The very words "gross abuse of trust" connote fiduciary standards and obligations. Since Congress declared that these fiduciary offices were not objects of sale and that aspirants to such offices were subject to election, payment to the present management or those in control for the succession is forbidden under equitable doctrines which courts of equity have enforced for at least one-hundred years, and of which, we may be sure, the Congress was aware when it enacted the broad and inclusive provisions of Sections 15 and 36. These equitable principles were discussed in the Commission's report of investigation with specific reference to the transfer of management contracts.⁶² Similar views were expressed by certain spokesmen for investment companies. Mr. Merrill Griswold, then and for many years later, chairman of the board of Massachusetts Investors Trust, the largest of the open-end companies, referring to the evils resulting from the sale of control, indicated that this practice might not be prevalent with respect to such investment trusts as are under no management contract but are managed by trustees who own only a small amount of the widely-held stock of the investment trust. He then continued:

It has been suggested that the trustees might sell out their office—in other words, that you could come to me and offer me so much money, and that I would resign, and the other trustees would elect, we shall say, Mr. De Ronde to take

⁶² See SEC Report, note 15, *supra*, pp. 1029, 1086.

my place, and then another one of us would resign and we would elect some other man; and in that way we could sell out.

The answer to that is that it is absolutely impossible for us to do that; because under the common law respecting fiduciaries, if we were crooked enough to do it, the funds we would receive would themselves belong to the company, and we could not keep them; and if we did keep them, we would be guilty of an embezzlement. In other words, we cannot "sell down the river" if we want to—and we do not want to.⁶³

Likewise, Mr. Hugh W. Long, then president of New York Stocks, Inc., also an open-end company, stated with specific reference to Section 15:

At the outset, let me say that we approve without reservation those provisions of Section 15 which require that the compensation of management be precisely defined and which provide for the cancellation of management and distributing contracts upon assignment of a contract or transfer of control of the company holding it. We quite agree that there should be no opportunity for investment companies to be "sold down the river." Although the transfer of a personal-service contract of a fiduciary nature is probably a violation of ordinary rules of law, we see no objection to a specific prohibition in this statute.⁶⁴

In short, Section 15 itself, broadly speaking, was looked upon as affirming and amplifying basic fidu-

⁶³ Hearings before the Senate Committee on Banking and Currency on S. 3580, 76th Cong., 3d Sess. (1940), p. 505.

⁶⁴ Hearings, etc., note 63, *supra*, p. 585.

ciary law and not as a surrogate for the historic trust obligations prescribed by courts of equity.

An illuminating illustration of the principle as applied under the Act was before the Commission in an uncontested case several years ago. The case involved Management Associates which performed investment advisory and other management services for Incorporated Investors, a registered open-end company.⁶⁵ Management Associates had 6,000 shares outstanding of which William Tudor Gardiner held 3,000 shares.⁶⁶ Upon his death these shares passed to his estate. It was assumed, without a formal determination, that this transfer constituted an "assignment" which terminated the advisory contract. Since a new agreement required approval of investors under Section 15 (a), a temporary arrangement for the continuation of the advisory services was made. Thereupon an application for an exemption for such continuance from Section 15 was filed with the Commission pursuant to Section 6 (c), pending a definitive disposition of the 3,000 shares by Gardiner's executors and a subsequent submission of a new advisory contract for approval by the investors of Incorporated Investors. That application was granted, *Incorporated Investors*, Investment Company Act Release No. 1911 (1953). The temporary exemption was thereafter extended on application which, as stated in the Commission's or-

⁶⁵ As of September 30, 1956, Incorporated Investors had net assets of about \$249,000,000. See Appendix B, p. 1, *infra*.

⁶⁶ The public files of the Commission show that the other remaining shares were then held by three other officers of Incorporated Investors as follows: 1,800 shares by William A. Parker, and 600 each by Amory Parker and George D. Aldrich.

der, contemplated the sale of the 3,000 shares to Management Associates, *Incorporated Investors*, Investment Company Act Release No. 1947 (1954). It further stated: "As consideration for the 3,000 shares of Management Associates' stock, Gardiner's estate will receive a cash payment equal to the value of one-half of the net assets of Management Associates, as shown by the books as of November 30, 1953. The assets as shown by the books comprise certain tangibles, receivables and cash, but no amount of any goodwill or contracts accrued by Management Associates."⁶⁷ In other words, for the 50% stock interest in the investment adviser, the executor neither sought nor received any payment because of the investment advisory relationship with the investment company. The parties and the Commission agreed that, since the contract is nonassignable, no value may properly be attributed to it for the benefit of the selling stockholder or his estate.

The narrow interpretation of Section 36 adopted by the court below may result in the recurrence of the

⁶⁷ Thereafter a new contract was approved by the shareholders of Incorporated Investors at a meeting held on March 24, 1954. The proxy statement apprised shareholders of the sale of the stock by the Gardiner estate to Management Associates and the proposed resale by Management Associates of part of the reacquired shares to two of its stockholders and the contemplated resale of additional shares to the president of Incorporated Investors. Subsequently Management Associates was liquidated into Parker Corporation which previously was the principal underwriter for Incorporated Investors.

Parker Corporation now is investment adviser and principal underwriter for Incorporated Investors. Its outstanding 6,000 shares are held by four stockholders. See Appendix B, p. 1, *infra*.

very abuses that the Act was designed to avoid. If the sale of stock control by the existing management at any price is beyond the reach of the statute, control may well be put on the auction block and sold to the highest bidder for the benefit of the management. No thought is likely to be given by those in control to use the occasion of the sale for improving the position of investors through more advantageous investment advisory or underwriting contracts with the successors, although under Section 15 the selection of the new adviser or underwriter is within the power and authority of the public investors. Moreover, those purchasing control may be tempted to pursue hazardous or doubtful policies in order to recoup as quickly as possible the substantial price they paid for control. In the instant case, the purchasers paid over \$4,000,000 in excess of the net asset value of the ISI stock (R. 8-9); and their estimates indicate a ten-year recoupment period at 4% interest (R. 112-115). We are not suggesting that the new controlling interests in ISI will abuse their fiduciary position with respect to the Trust Fund. But Sections 15 and 36 and the policies upon which they are based were designed to prevent such and other kindred abuses from again becoming a reality. It is immaterial whether in a particular situation such abuses may or may not be present. See *North American Co. v. SEC*, 327 U. S. 686, 710-711 (1946).

The intimation by the court below (R. 149) that, given the right to elect their investment adviser and principal underwriter, investors would overcome their inertia and mobilize in protest against those who

pay for the succession to these contracts, seems to us implausible and unrealistic. If the court below is sustained in its view that such transactions are proper and valid, it is not likely that the investors would undertake to oppose an entrenched management which legally or *de facto* is committed to further the interests of the successful bidder. Indeed, with the legality of these transactions no longer subject to question, the investors' trust and confidence in the old management, established over the years, will prove a weighty, and probably the controlling factor, in favor of its nominee or successor. Moreover, with respect to open-end companies, such as the Trust Fund in the instant case, whose securities are redeemable at net asset value, investors, who are not satisfied with the proposed successor, probably will exercise their right of redemption rather than engage in a contest against what may appear to them as hopeless odds.

Nor, by the same token, will prospective purchasers be deterred from paying substantial amounts for the succession to the advisory and underwriting services, as, indeed, this very case illustrates. For it would be naive to assume that the purchasers in this case were investing over \$4,000,000 in excess of the book value of the ISI stock, without the anticipated agreements with the Trust Fund or with indifferent feelings as to these agreements. It is equally naive to suppose that the purchasers would undertake this substantial investment with any actual apprehension that the outcome of the statutory vote might be in precarious balance, or that, on urging by investors, competing service agencies might intercede to wrest the proposed

new agreements from ISI. The real concern of both sellers and buyers, as the record amply demonstrates (R. 117-135), was over the sanctions prescribed by Section 36 in the light of the Commission's published interpretation of that Section as early as 1942 (R. 124-128).

The fact that, in the purchase contract for the third installment of 16,000 shares of ISI stock at an aggregate price of \$800,000, it was stipulated that this purchase was not conditioned on investor approval of the advisory or underwriting agreements with the Trust Fund (R. 66-68), does not suggest the purchasers' indifference to these agreements but rather that they entertained no apprehension regarding a favorable vote of the investors. Without pressing the point at this juncture, we suggest that this stipulation, and other devices, such as the staggering of the sale of the ISI stock in lots of less than 25% and insistence that the distribution of the stock also be so limited (R. 67, 110), were staged to give the transactions the surface appearance of stock sales. In the present context these maneuvers appear to have been undertaken in the hope or expectation that the Commission or the courts might resolve the issue under Section 36 for their benefit in terms of fiction rather than the actualities of the transactions. Needless to say, if the views of the court below should prevail, trading in these fiduciary arrangements will be more forthright, unencumbered by the stage props which the parties felt constrained to employ in this case.

In adverting to these practical considerations and consequences, we do not, of course, lose sight of the

fact that we are concerned here with a remedial statute and, more particularly, with a legislative determination to extirpate the baneful trafficking in fiduciary contracts, the results of which had brought grief and disaster to public investors. To the extent that the Act now provides investors with the means of denying the benefits of these contracts to successor interests for cause or otherwise, this is all to the good, and our construction of Sections 15 and 36 does not foreclose or affect these salutary avenues of self-help. But it stands to reason that in dealing with this problem the Congress intended to adopt measures equal to the task and purpose, so that the protection against these pernicious practices shall extend to all investors under all contingencies. The effectiveness of the prescribed remedies cannot be circumstantial, depending upon whether public investors are alert or inarticulate, suspicious or trusting, well-organized or diffused. Courts of equity have not withheld relief for breach of trust merely because, by effective organization and intelligent use of their voting rights, security holders could displace a management not to their liking. In response to the growing complexities of corporate life, courts of equity have exercised greater vigilance in the enforcement of fiduciary responsibilities, *Ashman v. Miller*, 101 F. 2d 85, 91 (C. A. 6, 1939) ;⁶⁸ and equita-

⁶⁸ The court said: "The growth of corporations and the disappearance of the individual and partnership forms of business have become so extensive and vital in our economic life, and so many artificial legal devices have been set up which serve to isolate the stockholder from control over his investment that directors and other officers of a corporation should be held to a strict accountability for their acts in its management."

ble remedies have been correspondingly expanded to meet these developments, *Union Pacific Railway Co. v. Chicago, etc., Railway Co.*, 163 U. S. 564, 600-601 (1895) (quoted page 67, *supra*). The same degree of vigilance and perception should be credited to the Congress, when it directed the courts to enforce fiduciary standards under Section 36.

The court below concluded that the Congress intended Section 36 to have a limited effect and stated that this was "evidenced by the fact that Section 36, when first considered by the Congress, applied to misconduct and abuse of trust *generally*" (R. 148) (*italics in original*).⁶⁹ The court's footnote reference is to S. 3580, 76th Cong., 3d Sess., introduced by Senator Wagner on March 14, 1940. In our view, a reading of this bill and the subsequent changes indicate a contrary intent.

The predecessor provision to Section 36 of the Act was Section 17 (e) of S. 3580 which read as follows:

Any gross misconduct or gross abuse of trust in respect of a registered investment company, on the part of any person registered under Section 9 as an affiliated person of or principal underwriter for such company, shall be unlawful.

Section 9 (a) of the bill then provided that, unless registered with the Commission, it was unlawful for any person to act as officer, director, manager, investment adviser or depositor of a registered investment company or as principal underwriter for a registered open-end investment company. The grounds for denying or revoking registration were set forth in Sec-

⁶⁹ The italics appear in the court's slip opinion and in 146 F. Supp. at 780.

tion 9 (d).” The word “generally” was not included, nor were its implications suggested, in the bill. Under S. 3580, as well as under Section 36 of the Act the gist of the wrong was “gross misconduct or gross

⁷⁰ Section 9 (a) of S. 3850 provided:

“It shall be unlawful for any person, unless registered under this section, to serve or act in any of the following capacities for a period exceeding sixty days:

“(1) as officers, director, manager, or investment adviser of or for a registered management investment company or registered face-amount certificate company;

“(2) as depositor, manager, or investment adviser of or for a registered unit investment trust;

“(3) as principal underwriter for a registered open-end management investment company, registered unit investment trust, or registered face-amount certificate company; or

“(4) as a distributor who makes use of the mails or any means or instrumentality of interstate commerce to engage in the business of selling periodic payment plan certificates, or as a salesman for such a distributor.”

Section 9 (d) (1) and (2) of S. 3850 provided:

“The Commission shall by order deny registration to, or revoke or suspend the registration of, an applicant under this section, if the Commission finds that such denial, revocation, or suspension is in the public interest and that—

“(1) the applicant, within ten years of the issuance of such order, has been convicted of any felony or misdemeanor involving the purchase or sale of any security, or arising out of the applicant’s conduct as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company;

“(2) the applicant, at the time of the issuance of such order, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security.”

abuse of trust in respect of a registered investment company," and investment advisers and principal underwriters were made subject to the sanctions therein prescribed. While the provisions for registration were not adopted, the grounds for denying or revoking registration of officers, directors, investment advisers, etc., under Sections 9 (d) (1) and (2) of S. 3580 are now included, as we have seen, as automatic bars and disqualifications under Section 9 (a) (1) and (2) of the Act.

The purpose of Section 17 (e) of S. 3580 was thus explained by counsel for the Commission:⁷¹

"Subsection (e) of Section 17 attempts to set forth a broad standard of conduct.

"You made a suggestion originally, Senator Taft, to this effect: Why can you not set forth in this bill a fiduciary obligation and make it a crime to violate that fiduciary obligation?

"When we came to draft a provision like that it presented a great many problems, because if you try to impose a trustee obligation on these managers, maybe that obligation is much too strict. A trustee in some instances may be liable for negligence. We felt that that was possibly too onerous an obligation to impose upon people who are managing investment companies. So we took the broader approach and said that if he was guilty of gross misconduct or gross abuse of trust, then he was guilty of a crime.

"Of course that does not mean that the Securities and Exchange Commission has the jurisdiction to determine whether he has been guilty

⁷¹ Hearings before Senate Committee on Banking and Currency on S. 3580, 76th Cong., 3d Sess. (1940), p. 262.

of gross abuse or gross misconduct, or gross abuse of trust. That is a criminal offense, and criminal action would have to be instituted against him."

An industry spokesman objected to this provision because by making such conduct "unlawful," it subjected persons to criminal penalties "for violation of an indefinite standard which was impossible of determination."⁷² By compromise this provision was recast as Section 36; and only civil sanctions were imposed for "gross misconduct or gross abuse of trust." As part of this compromise there was also included Section 37 of the Act which makes "unlawful" theft, embezzlement or conversion of "funds, securities, credits, property, or assets of any registered investment company."

It is clear from the foregoing that, except for the criminal implications in the bill, there was no basic disagreement on the substance of Section 36 or its predecessor. Only the criminal sanctions were narrowed and limited, so that a transaction constituting gross misconduct or gross abuse of trust under Section 36 is subject to criminal prosecution only if it is an "unlawful" act under the limited provisions of Section 37, which, of course, applies to all persons. Needless to say, when Section 36 was limited to a remedy for injunction, the term "unlawful" was obviously unnecessary in its civil setting. In short, since the critical language of the bill was retained in the final text, the same breadth and scope must be attrib-

⁷² Hearings before House Committee on Interstate and Foreign Commerce on H. R. 10065, 76th Cong., 3d Sess. (1940), p. 124.

uted to Section 36. As we have seen, the policy under Section 15 and historic equitable principles embodied in Section 36 so require.

Finally, appellees also argued below that no stock control was sold or transferred. They urged that Section 2 (a) (4), which refers to a transfer of a "controlling block" of securities, must be interpreted in the light of Section 2 (a) (9). Under this Section "control" means "the power to exercise a controlling influence over the management or policies of a company", and a presumption of control arises as to "any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company * * *". Appellees stated that each of the director-defendants held 18.2% of the outstanding ISI stock; that none of the purchasers owns or holds 25%; and that, accordingly, there was no sale or purchase of control.

It is readily evident from Section 2 (a) (9) that in any relevant transaction control is not necessarily dependent on stock ownership or on any particular percentage of stock. In connection with stock, 25% or more of the voting stock is deemed to constitute presumptive control. The Commission's complaint alleges that, "On or about February 1, 1956, the director-defendants either alone or in concert with others, embarked upon a plan to sell their stock interests to a small number of purchasers, affiliated among each other through stock ownership and otherwise" (R. 8). As further alleged in the complaint (R. 8-9), from February to July 1956, the director-defendants, pursuant to the plan, sold 68,000 shares of ISI stock, or about

40.8% of the total outstanding, while 13% was sold by other stockholders acting in concert with them.

We submit that if Section 36 applies when one person transfers control by a sale of more than 25% of the stock, it is equally applicable when control is transferred by a group of persons in the same aggregate amount pursuant to a plan. The possibilities for evading the statute if it were construed otherwise are too obvious to require further discussion. In *Pepper v. Litton*, 308 U. S. 295, 312 (1939), the court said:

No matter how technically legal each step in that scheme may have been, once its basic nature was uncovered it was the duty of the bankruptcy court in the exercise of its equity jurisdiction to undo it. Otherwise, the fiduciary duties of dominant or management stockholders would go for naught; exploitation would become a substitute for justice; and equity would be perverted as an instrument for approving what it was designed to thwart.

Appellees also denied that such a plan existed, and submitted affidavits in support of that contention (R. 55-58). The Commission filed counteraffidavits, (R. 104-123, 128-134), and the evidence thus far obtained, and as elsewhere summarized (pp. 7-10, *supra*), strongly supports the Commission's allegations that the transactions were executed pursuant to a plan. In any event, the proper method of raising these factual issues is by answer, not by a motion to dismiss or for summary judgment.⁷³ The court below said that it

⁷³ In their memorandum below, appellees stated in the alternative that their motion be considered as one for summary judgment under Rule 56 of the Federal Rules of Civil Procedure.

was "a very difficult thing to reach that sort of question on a motion to dismiss or even on a motion for summary judgment." (R. 160), and based its decision on the assumption that there was a sale of control within the meaning of the statute (R. 146-147).

The refusal of the court below to resolve these factual questions on motion is in accord with this Court's ruling in *Lane Bryant, Inc. v. Maternity Lane, Ltd.*, 173 F. 2d 559, 565 (C. A. 9, 1949):

The affidavits upon their broadest application do no more than to present to the trier of fact evidence upon material issues. They do not absorb the issues as matters of law. Therefore, the judgment cannot validly be based upon the summary trial by affidavits. The plaintiff-appellant is entitled to have its complaint responded to by answer and both parties are entitled to have the issues tried through the introduction of exhibits and witnesses produced for direct and cross examination.

A summary disposition on motion is particularly inappropriate here since the relevant facts are within the peculiar knowledge of the appellees and the purchasers. As the court said in *Toebelman v. Missouri-Kansas Pipe Line Co.* 130 F. 2d 1016, 1022 (C. A. 3, 1942):

It is obvious that this evidence must come largely from the defendants. This case illustrates the danger of founding a judgment in favor of one party upon his own version of facts within his sole knowledge as set forth in affidavits prepared ex parte. Cross-examination of the party and a reasonable examination of his records by the other party frequently

bring forth further facts which place a very different light upon the picture.

In such circumstances, even in the absence of counter-affidavits, the courts will not regard the matters set forth in the moving affidavits as admitted by the opposing party. See *Subin v. Goldsmith*, 224 F. 2d 753, 758-761 (C. A. 2, 1955), certiorari denied, 350 U. S. 883 (1955). Although appellees, at our request, have voluntarily furnished to us some documents, they do not appear to us complete, and, indeed, call for further inquiry, including examination and cross-examination of witnesses, so that the factual issues can be properly resolved by the court after answer and trial.

III. ISI and the director-defendants are persons subject to the sanctions of Section 36

Appellees argued below that, even if the transactions come within Section 36, ISI and the individual defendants are not persons within its interdiction. Section 36 applies to any "person"⁷⁴ who acts or serves as an "officer, director * * * investment adviser, or depositor" of any registered investment company, or as "principal underwriter" for an "open-end company." ISI is, of course, the investment adviser, depositor and principal underwriter for the Trust Fund, an open-end company. Appellees conceded, *arguendo*, that it would be wrong for ISI to sell its fiduciary position as investment adviser or principal underwriter, or for directors of the Trust Fund to do likewise with respect to their office. But,

⁷⁴ Section 2 (a) (27) defines a "person" as including a company.

they urged, the alleged misdeeds in this case were not committed by ISI but by its directors and controlling stockholders, while the director-defendants, the authors of the offending transactions, are not directors, officers, etc., of the Trust Fund, the investment company, but rather of ISI. Appellees' contention in effect is that immunity from Section 36 can readily be obtained, if the investment advisory and principal underwriting functions of the Trust Fund are performed by them through a separate corporation such as ISI, and the sale of the succession is effected by a sale of stock control of ISI. The court below, having determined that no wrongful act was committed under Section 36, did not reach this question. It did indicate, however, that if the transactions constituted gross misconduct or gross abuse of trust in respect of the Trust Fund, Section 36 would apply to appellees (R. 157-158). In anticipation that it will be argued by appellees to this Court, this question is briefed here.

In our view, the policy of the Congress against trading in investment advisory or principal underwriting contracts, and the related fiduciary standards and sanctions under Section 36, cannot be evaded as a consequence of incorporation. Investment advisory and principal underwriting services, as we have seen (pp. 49-52, *supra*) are essentially management functions, which the individual defendants through ISI are obliged to perform on behalf of the Trust Fund. Investors who purchased Participation Agreements in the Trust Fund did not put their faith and trust in an abstract corporate entity but in the professional

managers and in the direction and know-how they have undertaken to furnish to the investors. If, for convenience or other reasons, they wish to pool their individual skills in the form of a corporation, it is their privilege to do so. But, in exercising this privilege, they, surely, did not intend or expect to divert the investors' reliance to the corporate abstraction. The basic appeal to investors rests, as always, upon their personal capacities and qualifications; and their self-assumed fiduciary obligations, which run, directly or through ISI, to the Trust Fund and its investors, necessarily remain the same. In this case, indeed, these obligations are further accentuated and multiplied, since, when the wrongful transactions were executed, and for years prior thereto, ISI has had—and still has—no other business; the Trust Fund has had no other management except ISI; and the individual defendants were directors and officers and also controlling stockholders of ISI.⁷⁵

Public policy against trading in fiduciary contracts and the corresponding sanctions under Section 36 are too firm and exacting to yield to the *tour de force* which appellees contrived here. Had the individuals involved in this case been content to act as investment advisers or principal underwriters of the Trust Fund

⁷⁵ See *Perlman v. Feldmann*, 219 F. 2d 173, 178 (C. A. 2, 1955), certiorari denied, 349 U. S. 952 (1955), wherein Feldmann, the principal defendant, was the president, chairman of the board of directors and the dominant stockholder, the court said: "In this case the violation of duty seems to be all the clearer because of this triple role in which Feldmann appears, though we are unwilling to say, and are not to be understood as saying, that we should accept a lesser obligation for any one of his roles alone."

directly, it is conceded, *arguendo*, that they could not have sold the succession to their position without incurring the sanctions prescribed by Section 36. They cannot escape the statutory consequences if they commit the wrongful act indirectly, merely because they have chosen to discharge their commitments to the Trust Fund through ISI or because they have assumed the titular positions of directors and officers of ISI rather than of the Trust Fund. Accordingly, when Section 36 directs the removal of the investment adviser or principal underwriter for gross misconduct or gross abuse of trust, it is immaterial whether the offending transaction against the Trust Fund is committed by the ostensible or official occupants of these positions or by those who manage and dominate the investment adviser or principal underwriter. See *Ashman v. Miller*, 101 F. 2d 85, 91 (C. A. 6, 1939), quoted note 68, *supra*; *Ripperger v. Allyn*, 25 F. Supp. 554, 555 (S. D. N. Y. 1938), quoted note 81, *infra*.⁷⁶ By the same token the court whose jurisdiction is invoked under Section 36 may require that those initiating the wrongful acts should account for the benefits derived as a consequence of the breach of trust.⁷⁷ This construction of the statute is clearly es-

⁷⁶ Cf. *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1919), where the court said: "It is the fact of control of the common property held and exercised, not the particular means by which or the manner in which the control is exercised, that creates the fiduciary obligation."

⁷⁷ See *Aldred Investment Co. v. SEC*, 151 F. 2d 254, 261 (C. A. 1, 1945), certiorari denied, 326 U. S. 795 (1946), where the court said: "Section 36 invokes the equity power of the Federal Court and that calls into play its inherent powers where necessary to do justice and grant full relief."

sential, if Sections 15 and 36 are to fulfill the purposes that the Congress intended, while the alternative of complete immunity for which appellees argue provides a ready means for evading the statutory policy.⁷⁸

We reach the same conclusion under equitable principles and under the statute if the problem is approached from the point of view of ISI's own particular relationship to the Trust Fund and its public investors. It is familiar doctrine that one who, not otherwise under any fiduciary obligation, participates in the commission of a breach of trust, is liable for the consequences of the breach. See *Jackson v. Smith*, 254 U. S. 586 (1921). Liability is also imposed upon a fiduciary who condones activities, detrimental to the trust, committed by those employed to assist the fiduciary in managing the trust estate. See *Mosser v. Darrow*, 341 U. S. 267 (1951), where in holding the trustee liable for the profits realized by his subordinates as a result of their trading in the capital stock of the corporation's subsidiaries, the court said (341 U. S. at 272): "We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for benefit of others as they would have been on behalf of the trustee himself." In a word, to courts of equity the trust obligation is not only personal but

⁷⁸ *Cf.* Section 48 (a), subtitled "Liability of Controlling Persons: * * *", which makes it unlawful "for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do" under the Act.

also vicarious, and the same basic principles apply here.

ISI has no proprietary interest in its investment advisory and principal underwriting relationships to the Trust Fund. Its services are essentially of a fiduciary character, and, as trustee, ISI may continue to render these services, under the voting procedures set forth in Section 15, only for the purpose of discharging its obligations to the Trust Fund, and for no other. The sale of its fiduciary position is not one of the prerogatives attached to its office. In fact, the practice is contrary to the policy and provisions of Section 15, and equitable principles forbid it. Since ISI, in its corporate capacity, may not engage in such transaction, its directors and officers cannot sell ISI's fiduciary office for their own benefit as majority stockholders. From the point of view of the Trust Fund and its investors, the dangers inherent in the trading of ISI's fiduciary relationships are precisely the same, whether such trading is endorsed or undertaken by every member of the corporate body or by the controlling and managing organs of the corporation.

If, as a practical matter, ISI could not prevent the transaction or seek an accounting for the benefit of the Trust Fund, neither could it withhold its official consent, had such consent been sought by the director-defendants and the other participants in the sale. It should be recalled that prior to the first transaction in the ISI stock in February 1956, ISI had nine stockholders (R. 7-8), and that eight of these participated in the sales (R. 9, 56-59). The nonpartici-

pating stockholder is the owner of only 6/10 of one percent of the outstanding ISI stock (R. 8, 9). If we look at the composition of ISI stockholders involved in all of the transactions between February and July of 1956, and up to the filing of the lawsuit, it is evident that, except for the same nonparticipant, all of them at one point or another were either sellers or direct purchasers from these sellers (R. 8-9, 56-59). To require formal corporate participation or consent as a condition precedent for imposing upon ISI the sanctions and liabilities under Section 36, when those in control and others have determined to engage in the stock transactions, is to rest on form and to abandon substance. Statutory policy and fiduciary standards cannot be thus administered and enforced.

The construction of Section 36, as urged herein, is required by the cognate provisions of Section 15 with respect to the consequences of an assignment. Section 15 (a) (4) requires that the investment advisory contract provide for its automatic termination in the event of "its assignment by the investment adviser." Section 15 (b) (2) prescribes similarly with respect to the contract of the principal underwriter for an open-end company in the event of "its assignment by such underwriter." Under the definition in Section 2 (a) (4), every assignment is included, "direct or indirect." As we have previously explained (pp. 43-44, *supra*), the Congress specifically envisioned that investment advisory and principal underwriting services might be performed by persons not only as individuals but also through a corporation. Having in mind that the character and quality of these fiduciary services

may also be seriously affected by a sale of stock control, the Congress provided that an assignment by the corporate investment adviser or principal underwriter occurs also upon a transfer of "a controlling block of the assignor's outstanding voting securities by a security holder of the assignor." When thus read together, Sections 2 (a) (4) and 15 clearly treat the sale of a controlling stock interest in ISI as an indirect assignment of the contracts by ISI, even though formally these contracts were between ISI and the Trust Fund and the stock transactions were between ISI stockholders and third parties. When, in addition, the assignment involves a breach of trust, the imputation of the assignment to ISI is no less essential or mandatory.

A similar approach is expressed in Section 9 (a) (3) which makes it unlawful for a company to act as investment adviser or principal underwriter for a registered investment company, as therein specified, if an "affiliated person" of such company "is ineligible" to serve the investment company in any of the positions specified in Sections 9 (a) (1) and (2). This means, for example, that when a director, officer or a 5% stockholder engaged in any securities transaction which resulted in his criminal conviction within the past ten years or subjected him to a permanent or temporary injunction in connection therewith, the corporation is automatically disqualified as an investment adviser or principal underwriter for any investment company.

Section 9 (a) (3) thus represents a Congressional determination that the corporate fiduciary is not

permitted to remain in its position of trust if it retains within its organization an affiliated person involved in any wrongful securities transactions, the underlying assumption being that the retention of such person represents a danger to the investment company and its public security holders. Likewise, Section 36, within its specific context, cannot be construed in a manner that would provide immunity for the corporate investment adviser or principal underwriter when the persons in control have engaged in transactions which under Section 36 and applicable equitable principles constitute gross misconduct or gross abuse of trust in respect of the investment company.

The enforcement of fiduciary standards as urged herein is a particular application of a principle which courts have applied in the wider area of corporate law.⁷⁹ It is aptly illustrated in the leading case of *State ex rel. Attorney General v. Standard Oil Co.*, 49 Ohio St. 137, 30 N. E. 279 (1890). In that case holders of all but seven of the defendant corporation's outstanding shares transferred their shares to trustees who, pursuant to an agreement with these stockholders and others engaged in the same business as the defendant, combined to form a monopoly and to engage in restraint of trade. The court held that the combination was illegal and that, since as a consequence of the agreement the trustees dominated the affairs of the corporation, liability must be imposed upon the corporation. The court rejected the contention that the corporation had never authorized the

⁷⁹ See generally 1 Fletcher, *Corporations* § 42 (Perm. Ed. 1931).

arrangement and was not a party to it. It pointed out that the corporate fiction was a device of convenience which the courts will recognize only so long as the powers and privileges under corporate franchise are not abused and employed for unlawful purposes by the corporation or those in control. The court said (49 Ohio St. at 184, 30 N. E. at 289-290):

It therefore follows * * * that where all, or a majority, of the stockholders comprising a corporation do an act which is designed to affect the property and business of the company, and which, through the control their numbers give them over the selection and conduct of the corporate agencies, does affect the property and business of the company, in the same manner as if it had been a formal resolution of its board of directors, and the act so done is *ultra vires* of the corporation and against public policy * * * the act should be regarded as the act of the corporation; * * * ⁸⁰

Moreover, we do not agree that the director-defendants of ISI were not also directors and officers of the Trust Fund when they sold their stock and when this suit was brought. Section 36 applies to a person who "serves or acts * * * as officer, director" of an investment company. Section 2 (a) (12) de-

⁸⁰ The same principle was applied in a similar case where all the stockholders joined in the illegal agreement. *People v. North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 834 (1890). The court rejected the argument based on the separate corporate entity, saying that to accept it would mean that "while all that was human and could act had sinned, yet the impalpable entity had not acted at all, and must go free." *Cf. Majestic Co. v. Orpheum Circuit, Inc.*, 21 F. 2d 720, 724 (C. A. 8, 1927).

finer the term "director" as including not only a director of a corporation but also "any person performing similar functions with respect to any organization, whether incorporated or unincorporated * * *". In the instant case the Trust Fund had no separate management of its own, and all policy and management functions were performed by the director-defendants and their associates on the board of ISI. The prospectus of the Trust Fund specifically recognizes that. It states: "The Board of Directors of Insurance Securities, Incorporated is composed of eleven members. As the Trust Fund has no officers or Board of Directors, the officers and directors of Insurance Securities Incorporated render their services to the Trust Fund" (R. 111).⁸¹

We recognize that enforcement of Section 36, as urged here, would affect a minority interest in ISI not in complicity with the director-defendants. But it should be recalled that the stockholders of ISI, like ISI itself, have no vested or indefeasible interest in ISI's contracts with the Trust Fund. The right and privilege of designating the investment adviser and principal underwriter belong to the Trust Fund

⁸¹ See *Ripperger v. Allyn*, 25 F. Supp. 554 (S. D. N. Y. 1938), where the court denied a motion to dismiss a bill in equity seeking an accounting from certain securities dealers for the profits derived from diverting to themselves an opportunity allegedly belonging to a corporation. The court said: "The security dealers were not directors of the corporation. But the charge is made that the directors always did their bidding and acted for their individual interests. If this is true, the security dealers were in fact the managers of the corporate affairs and stood in a fiduciary relationship to the corporation equivalent to that of directors and officers."

and its investors, not to the stockholders of ISI. Under Section 15 (a) (3) ISI's investment advisory contract must provide for its termination on 60 days' notice without penalty. ISI's investment advisory and principal underwriting contracts with the Trust Fund must be renewed by investors of the Trust Fund or the Trust Fund's own board of directors under Section 15, as the case may be, and come to an end if not so renewed. The sale of stock control of ISI terminates these contracts, and a minority stockholder cannot complain if, as a consequence, new contracts should be made with someone other than ISI. When the sale of control of ISI is effected under circumstances involving also a breach of trust, as in this case, a minority stockholder of ISI cannot object in this action, if as a result of such termination and a court decree under Section 36, ISI is precluded from competing with other servicing agencies for new contracts with the Trust Fund. Accordingly, his minority interest in ISI and his expectations, subject as they are to these statutory contingencies, do not justify withholding the relief prescribed by Section 36.

Moreover, the remedies which may be applied under Section 36 are not fixed or rigid. Under Section 36, the court, as a court of equity, has the power to grant such equitable relief as in the light of all the facts appears appropriate and consistent with the statutory purpose.⁸² There is no reason for assuming

⁸² It was expressly so held in *Aldred Investment Co. v. SEC*, 151 F. 2d 254, 260-261 (C. A. 1, 1945), certiorari denied, 326 U. S. 795 (1946). See also *Bailey v. Proctor*, 166 F. 2d 392 (C. A. 1, 1948).

that, after trial, the court will impose all permissible sanctions under Section 36 regardless of the interest of investors in the Trust Fund.⁶³ Obviously, the court will consider all relevant circumstances. In the present posture of the case it is premature to determine the scope of relief that may be necessary and appropriate; and the Commission's request for relief in its amended complaint (R. 14-15, 47-48) is in accord with the provisions of Section 36 and the equitable powers of the court thereunder.

IV. The amended complaint states a cause of action under Rule X-14A-9 of the Commission's Proxy Rules

Section 20 (a) of the Act in substance makes it unlawful to solicit proxies in respect of a security of a registered investment company "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate * * * for the protection of investors." Rule N-20A-1, promulgated under the Act, makes applicable the Proxy Rules adopted by the Commission under Section 14 (a) of the Securities Exchange Act of 1934. The relevant provision here is Rule X-14A-9 which states:

No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communi-

⁶³ Cf. Section 9 (b) which provides that, where a person is barred from acting as director, officer, investment adviser or principal underwriter because of an injunction or other reasons there specified, the Commission, on application, may grant appropriate relief, if it appears that as to such person the bar is "unduly or disproportionately severe" and that the granting of such application is "not against the public interest or protection of investors."

cation, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

This Rule prohibits the solicitation of proxies by means of proxy material which is false or misleading or which omits to state any material facts necessary to make any statement in the proxy material not false or misleading. It also provides that such omission is in contravention of the Rule, if the omitted material is necessary to "correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading." As a second cause of action the Commission's complaint alleges a violation of this Rule (R. 11-14).

In substance, the Commission's amended complaint alleges that the proxy material prepared and used by ISI in the solicitation of proxies for investor approval of new investment advisory and principal underwriting contracts, was false and misleading in that it failed to disclose material facts, including the price received by the director-defendants for their ISI stock, the net asset value of the ISI stock, and the pecuniary benefits the director-defendants had realized as a consequence of the sale of stock control

(R. 13, 47). Also, the ISI proxy letter sent to investors in the Trust Fund stated that the change in control of ISI may have "the technical effect" of terminating ISI's investment advisory and principal underwriting contracts with the Trust Fund (R. 21). Since such change in control has also resulted in subjecting ISI and the director-defendants to the sanctions of Section 36, it was false and misleading to characterize such effect as merely "technical" (R. 12-13).

The court below did not reach this question, since the alleged proxy violation was expressly dependent upon the cause of action under Section 36 (R. 11), and the court held that no such cause of action was alleged as a matter of law. The court said: "While the complaint sets forth two causes of action, it is clear, and indeed it is admitted, that the second cause of action stands or falls upon the validity of the first. Consequently, it is unnecessary to discuss the second cause of action" (R. 150). We assume that this Court will determine the legal sufficiency of the cause of action alleged under Rule X-14A-9, if, as we contend, a cause of action under Section 36 is properly alleged. Accordingly, we discuss the issues here.

In support of their motion to dismiss the second cause of action, appellees made two arguments; (1) that the staff of the Commission had reviewed the proxy material and did not suggest that the alleged omissions be supplied; (2) that the proxy material met the requirements of the Rule. Both contentions, we submit, are without merit.

In its letter of comment on ISI's preliminary proxy material, dated July 10, 1956, the staff of the Commission suggested certain changes (R. 103-104), which were complied with. But this letter also stated (R. 104) :

We understand that our Division of Corporate Regulation has raised certain questions regarding the assignment of the Investment Advisory and Underwriting Contracts.

The defendants contended that this reference was only to the applicability of Section 36 and not to the adequacy of the proxy material, as though the two matters were unrelated. It is clear, however, that such was not the intent of the letter.

That letter merely indicated certain changes and revisions which could at that time be definitively suggested. Obviously, such disclosures as might be required in light of the applicability of Section 36 could not then be made, since the problem raised under that Section had not been definitively resolved by the Commission and its staff (R. 138-140). The record also shows that the adequacy of the proxy material in the light of Section 36 was still an open question, and that appellees so understood (R. 97-102). In a telephone conversation with a member of the Commission's staff five days before the proxy material was mailed by ISI to investors, Mr. Haight, secretary and director of ISI and one of the appellees herein, was specifically requested to furnish certain information so that the Commission might resolve the problem under Section 36. In the course of that conversation Mr. Haight inquired whether the proxy solicitation mate-

rial could be mailed out, and he was advised (R. 100-101):

* * * that the matter of mailing the proxy material should be considered in the light of the Section 36 problem we had raised and that if there was a mailing before we had studied the matter, they would have to assume the risk that the Commission may resolve the problem adversely to them.

In his affidavit Mr. Haight states in response (R. 76): "Never, by letter or otherwise, did anyone in the Securities and Exchange Commission suggest or request any further or different changes or revisions or intimate that any should be made." This does not controvert or deny the advice given to him by the Commission's staff.

In any event it is evident that in order to resolve in its own mind the applicability of Section 36, the Commission needed certain information, including the critical fact of price paid for the ISI stock. This and other information did not reach the Commission until about eight days after the definitive proxy material had been mailed to investors in the Trust Fund (R. 101-102, 105-106, 122).

The purpose of requiring the filing of preliminary proxy material under Rule X-14A-6 is to enable the Commission to aid the companies and their managements, and to assure, as far as possible, full compliance with the intent and purpose of the Proxy Rules. Under the view urged by appellees this procedure would not be feasible, if the Commission were estopped from enforcing the Proxy Rules because it

failed to comment on the preliminary material through lack of information or otherwise. The absence of comment will be a certainty where, as in the instant case, the relevant information is within the possession of the persons making the solicitation but not known to the staff or the Commission.

The substantive question here involved is whether the omitted information was material and whether failure to disclose it constitutes a violation of the Proxy Rules. The purpose of the Proxy Rules is to require full disclosure of material information as well as the elimination of untrue and misleading statements, so that the security holder whose proxy is solicited may be better able to exercise his informed judgment in casting his vote. The court said in *SEC v. Okin*, 58 F. Supp. 20, 23 (S. D. N. Y. 1944) :

The Acts in question were clearly adopted by Congress to protect the interest of investors in securities, to require the giving to them of information necessary to appraise the financial position of such securities, and to furnish them with information which would enable them to act intelligently in the giving of proxies and in other transactions in the companies in which they held securities.⁸⁴

In terms of these standards it is clear that the investors in the Trust Fund were not adequately apprised of the facts so as to be able to exercise an informed judgment. Their proxies were solicited by ISI and its management, *inter alia*, for the purpose of securing their consent to new investment advisory

⁸⁴ See also, Loss, *Securities Regulation* (1951), pp. 523ff.

and principal underwriting contracts between ISI and the Trust Fund, as a consequence of the transfer of stock control of ISI. To that end it was not enough merely to advise the investors in general terms that there was such transfer. ISI and its management, as fiduciaries of the Trust Fund, should have also advised investors of the relevant details regarding the stock transactions which led to the shift in control of ISI and the financial benefits which accrued therefrom to the director-defendants. When asked for their consent, investors are entitled to appraise whether the recommendations of the management are disinterested or moved by considerations of personal gain. *Cf. Dunnett v. Arn*, 71 F. 2d 912, 919-920 (C. A. 10, 1934). Nor may it be represented to them that the transfer of control had the "technical effect" of terminating ISI's contracts when, as we contend, a gross abuse of trust was also involved as a result of such transfer.

Appellees also urged that a proxy statement cannot be misleading unless it is related to some affirmative statement or representation already contained in the proxy statement. This is without any merit. Failure to disclose material information is as much an abuse of the proxy machinery as an outright falsehood or an ambiguous statement deliberately contrived. The effect upon public investors is the same. In construing language under another statute almost identical in wording with that provided in Rule X-14A-9, the court said in *Hughes v. SEC*, 174 F. 2d 969, 976 (C. A. D. C. 1949):

These quoted words as they appear in the statute can only mean that Congress forbid not only the telling of purposeful falsity but also the telling of half-truths and the failure to tell the "whole truth." These statutory words were obviously designed to protect the investing public as a whole whether the individual investors be suspicious or unsuspecting.⁸⁵

We recognize that appellees disagree with the Commission's construction of Section 36 and related provisions of the Act, and the dilemma this posed for ISI and its management when soliciting proxies in advance of a resolution of the relevant problems under Section 36. But that is a risk which they, not the public investors, must assume. At the very least ISI might have disclosed the relevant information, including the questions raised under Section 36, with an appropriate opinion thereon by its own counsel. The assumption that in soliciting proxies ISI and its directors can limit their disclosures solely in the light of their own conclusion as to the scope of Section 36, seems to us fallacious.

We are advised that at the adjourned meeting of investors in the Trust Fund, held on September 14, 1956, the proxies were exercised in favor of new investment advisory and principal underwriting contracts between ISI and the Trust Fund (R. 141). But that does not preclude the granting of appropriate relief, if, as we contend, the proxies were unlawfully solicited. See *May v. SEC*, 134 F. Supp. 247 (S. D. N. Y. 1955), affirmed on appeal 229 F. 2d 123

⁸⁵ Cf. *Equitable Life Ins. Co. v. Halsey, Stuart & Co.*, 312 U. S. 410, 425-426 (1941).

(C. A. 2, 1956). The Commission's motion for a preliminary injunction was withdrawn upon the understanding, as set forth in the Second Interlocutory Order, that it was without prejudice to the power of the court to grant appropriate relief, "including any action with respect to the Investment Advisory and Principal Underwriting Contracts, whether or not approved by Investors in the Trust Fund, if it is determined in a final decree that plaintiff is entitled to judgment" (R. 95).

CONCLUSION AND RELIEF SOUGHT

The order of the court below should be reversed and the case remanded to the court below. More particularly, we respectfully urge this Court to make the following determinations:

First. The order of the court below dismissing the Commission's amended complaint should be reversed and the amended complaint reinstated.

Second. In the interest of expedition a determination should be made, if this Court deems it appropriate, that the amended complaint alleges a violation of Rule X-14A-9 of the Commission's Proxy Rules.

Third. The order of the court below dismissed the complaint and also dissolved the Second Interlocutory Order of August 30, 1956 (R. 151-152). The Commission appealed from both parts of the order (R. 152-153). The Second Interlocutory Order (R. 93-95), summarized pp. 14-15, *supra*, was entered on stipulation of the parties (R. 95). Pursuant thereto appellees undertook to refrain from taking certain actions pending a final determination of the case. We respectfully

suggest that on remand the Second Interlocutory Order be reinstated.

Respectfully submitted.

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JULY 1957.

APPENDIX A

The following are pertinent provisions of the Investment Company Act of 1940, 15 U. S. C. 80 (a)-1, *et seq.*:

SEC. 1. (a) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment companies are affected with a national public interest in that, amount other things—

(1) the securities issued by such companies, which constitute a substantial part of all securities publicly offered, are distributed, purchased, paid for, exchanged, transferred, redeemed, and repurchased by use of the mails and means and instrumentalities of interstate commerce, and in the case of the numerous companies which issue redeemable securities this process of distribution and redemption is continuous;

* * * * *

(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—

* * * * *

(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment

companies are managed by irresponsible persons;

* * * *

(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

* * * *

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

GENERAL DEFINITIONS

SEC. 2. (a) When used in this title, unless the context otherwise requires—

* * * *

(2) "Affiliated company" means a company which is an affiliated person.

(3) "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other

person is an unincorporated investment company not having a board of directors, the depositor thereof.

(4) "Assignment" includes any direct or indirect transfer or hypothecation of a contract or chose in action by the assignor, or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but does not include an assignment of partnership interests incidental to the death or withdrawal of a minority of the members of the partnership having only a minority interest in the partnership business or to the admission to the partnership of one or more members who, after such admission, shall be only a minority of the members and shall have only a minority interest in the business.

* * * * *

(12) "Director" means any director of a corporation of any person performing similar functions with respect to any organization, whether incorporated or unincorporated, including any natural person who is a member of a board of trustees of a management company created as a common-law trust.

* * * * *

(19) "Investment adviser" of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company, and (B) any other person who pursuant to contract with a person described in clause (A) regularly performs substantially all of the duties undertaken by such person described in clause (A); but does not include (i) a person whose advice is

furnished solely through uniform publications distributed to subscribers thereto, (ii) a person who furnishes only statistical and other factual information, advice regarding economic factors and trends, or advice as to occasional transactions in specific securities, but without generally furnishing advice or making recommendations regarding the purchase or sale of securities, (iii) a company furnishing such services at cost to one or more investment companies, insurance companies, or other financial institutions, (iv) any person the character and amount of whose compensation for such services must be approved by a court, or (v) such other persons as the Commission may by rules and regulations or order determine not to be within the intent of this definition.

* * * * *

(27) "Person" means a natural person or a company.

(28) "Principal underwriter" of or for any investment company other than a closed-end company, or of any security issued by such a company, means any underwriter who as principal purchases from such company, or pursuant to contract has the right (whether absolute or conditional) from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company.

* * * * *

(31) "Redeemable security" means any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approxi-

mately his proportionate share of the issuer's current net assets, or the cash equivalent thereof.

* * * *

CLASSIFICATION OF INVESTMENT COMPANIES

SEC. 4. For the purposes of this title, investment companies are divided into three principal classes, defined as follows:

(1) "Face-amount certificate company" means an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding.

(2) "Unit investment trust" means an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust.

(3) "Management company" means any investment company other than a face-amount certificate company or a unit investment trust.

SUBCLASSIFICATION OF MANAGEMENT COMPANIES

SEC. 5. (a) For the purposes of this title, management companies are divided into open-end and closed-end companies, defined as follows:

(1) "Open-end company" means a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer.

(2) "Close-end company" means any management company other than an open-end company.

(b) Management companies are further divided into diversified companies and non-diversified companies, defined as follows:

(1) "Diversified company" means a management company which meets the following requirements: At least 75 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 per centum of the value of the total assets of such management company and to not more than 10 per centum of the outstanding voting securities of such issuer.

* * * *

INELIGIBILITY OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS

SEC. 9. (a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:

(1) any person who within ten years has been convicted of any felony or misdemeanor involving the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company;

(2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment

adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security; or

(3) a company any affiliated person of which is ineligible, by reason of paragraph (1) or (2), to serve or act in the foregoing capacities.

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(b) Any person who is ineligible, by reason of subsection (a), to serve or act in the capacities enumerated in that subsection, may file with the Commission an application for an exemption from the provisions of that subsection. The Commission shall by order grant such application, either unconditionally or on an appropriate temporary or other conditional basis, if it is established that the prohibitions of subsection (a), as applied to such person, are unduly or disproportionately severe or that the conduct of such person has been such as not to make it against the public interest or protection of investors to grant such application.

AFFILIATIONS OF DIRECTORS

SEC. 10. (a) After one year from the effective date of this title, no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such registered company.

(b) After one year from the effective date of this title, no registered investment company shall—

(1) employ as regular broker any director, officer, or employee of such registered company, or any person of which any such director, officer, or employee is an affiliated person, unless a

majority of the board of directors of such registered company shall be persons who are not such brokers or affiliated persons of any of such brokers;

(2) use as a principal underwriter of securities issued by it any director, officer, or employee of such registered company or any person of which any such director, officer, or employee is an affiliated person, unless a majority of the board of directors of such registered company shall be persons who are not such principal underwriters or affiliated persons of any of such principal underwriters; or

(3) have as director, officer, or employee any investment banker, or any affiliated person of an investment banker, unless a majority of the board of directors of such registered company shall be persons who are not investment bankers or affiliated persons of any investment banker. For the purposes of this paragraph, a person shall not be deemed an affiliated person of an investment banker solely by reason of the fact that he is an affiliated person of a company of the character described in section 12 (d) (3) (A) and (B).

* * * * *

(h) In the case of a registered management company which is an unincorporated company not having a board of directors, the provisions of this section shall apply as follows:

* * * * *

(2) the provisions of subsections (b) and (c), as modified by subsection (e), shall apply to the board of directors of the depositor and of every investment adviser of such company;

* * * * *

INVESTMENT ADVISORY AND UNDERWRITING CONTRACTS

SEC. 15. (a) After one year from the effective date of this title it shall be unlawful for any person to

serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser.

(b) After one year from the effective date of this title, it shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract, unless in effect prior to March 15, 1940—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment by such underwriter.

(c) In addition to the requirements of subsections (a) and (b) it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company.

(d) It shall be unlawful for any person—

(1) to serve or act as investment adviser of a registered investment company, pursuant to a written contract which was in effect prior to March 15, 1940, after March 15, 1945, or the date of termination provided for in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as investment adviser thereunder; or

(2) as principal underwriter for a registered open-end investment company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, pursuant to a written contract which was in effect prior to March 15, 1940, after March 15, 1945, or the date of termination provided for in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as principal underwriter thereunder:

Provided, however, That the limitation to March 15, 1945, shall not apply in either case if prior to that date such contract is renewed in such form that it complies with the requirements of subsection (a) or (b) of this section, as the case may be, and is approved in the manner required by this section in respect of a contract of the same character made after March 15, 1940.

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TRANSACTIONS OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS

SEC. 17. (a) It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company (other than a company of the character described in section 12 (d) (3) (A) and (B)), or any affiliated person of such a person, promoter, or principal underwriter, acting as principal—

(1) knowingly to sell any security or other property to such registered company or to any company controlled by such registered company, unless such sale involves solely (A) securities of which the buyer is the issuer, (B) securities of which the seller is the issuer and which are part of a general offering to the holders of a class of its securities, or (C) securities deposited with the trustee of a unit investment trust or periodic payment plan by the depositor thereof;

(2) knowingly to purchase from such registered company, or from any company controlled by such registered company, any security or other property (except securities of which the seller is the issuer); or

(3) to borrow money or other property from such registered company or from any company controlled by such registered company (unless

the borrower is controlled by the lender) except as permitted in section 21 (b).

(b) Notwithstanding subsection (a), any person may file with the Commission an application for an order exempting a proposed transaction of the applicant from one or more provisions of that subsection. The Commission shall grant such application and issue such order of exemption if evidence establishes that—

(1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned;

(2) the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under this title; and

(3) the proposed transaction is consistent with the general purposes of this title.

* * * * *

PROXIES; VOTING TRUSTS; CIRCULAR OWNERSHIP

SEC. 20. (a) It shall be unlawful for any person, by use of the mails or any means or instrumentality of interstate commerce or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security of which a registered investment company is the issuer in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * * * *

PLANS OF REORGANIZATION

SEC. 25. (a) Any person who, by use of the mails or any means or instrumentality of interstate commerce

or otherwise, solicits or permits the use of his name to solicit any proxy, consent, authorization, power of attorney, ratification, deposit, or dissent in respect of any plan of reorganization of any registered investment company shall file with, or mail to, the Commission for its information within twenty-four hours after the commencement of any such solicitation, a copy of such plan and any deposit agreement relating thereto and of any proxy, consent, authorization, power of attorney, ratification, instrument of deposit, or instrument of dissent in respect thereto, if or to the extent that such documents shall not already have been filed with the Commission.

(b) The Commission is authorized, if so requested, prior to any solicitation of security holders with respect to any plan of reorganization, by any registered investment company which is, or any of the securities of which are, the subject of or is a participant in any such plan, or if so requested by the holders of 25 per centum of any class of its outstanding securities, to render an advisory report in respect of the fairness of any such plan and its effect upon any class or classes of security holders. In such event any registered investment company, in respect of which the Commission shall have rendered any such advisory report, shall mail promptly a copy of such advisory report to all its security holders affected by any such plan: *Provided*, That such advisory report shall have been received by it at least forty-eight hours (not including Sundays and holidays) before final action is taken in relation to such plan at any meeting of security holders called to act in relation thereto, or any adjournment of any such meeting, or if no meeting be called, then prior to the final date of acceptance of such plan by security holders. In respect of securities not registered as to ownership, in lieu of mailing a

copy of such advisory report, such registered company shall publish promptly a statement of the existence of such advisory report in a newspaper of general circulation in its principal place of business and shall make available copies of such advisory report upon request. Notwithstanding the provision of this section the Commission shall not render such advisory report although so requested by any such investment company or such security holders if the fairness or feasibility of said plan is in issue in any proceeding pending in any court of competent jurisdiction unless such plan is submitted to the Commission for that purpose by such court.

(c) Any district court of the United States in the State of incorporation of a registered investment company or any such court for the district in which such company maintains its principal place of business is authorized to enjoin the consummation of any plan of reorganization of such registered investment company upon proceedings instituted by the Commission (which is authorized so to proceed upon behalf of security holders of such registered company, or any class thereof), if such court shall determine any such plan to be grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors, or investment advisers of such registered company or other sponsors of such plan.

* * * * *

INJUNCTIONS AGAINST GROSS ABUSE

SEC. 36. The Commission is authorized to bring an action in the proper district court of the United States or United States court of any Territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has been guilty, after the enactment of this title and within five years

of the commencement of the action, of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts:

(1) as officer, director, member of an advisory board, investment adviser, or depositor; or

(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If the Commission's allegations of such gross misconduct or gross abuse of trust are established, the court shall enjoin such person from acting in such capacity or capacities either permanently or for such period of time as it in its discretion shall deem appropriate.

LARCENY AND EMBEZZLEMENT

SEC. 37. Whoever steals, unlawfully abstracts, unlawfully and willfully converts to his own use or to the use of another, or embezzles any of the moneys, funds, securities, credits, property, or assets of any registered investment company shall be deemed guilty of a crime, and upon conviction thereof shall be subject to the penalties provided in section 49. A judgment of conviction or acquittal on the merits under the laws of any State shall be a bar to any prosecution under this section for the same act or acts.

* * * * *

LIABILITY OF CONTROLLING PERSONS; PREVENTING COMPLIANCE WITH TITLE

SEC. 48. (a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the

provisions of this title or any rule, regulation, or order thereunder.

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RULES AND REGULATIONS

Rule N-20A-1 promulgated pursuant to Section 20 (a) of the Investment Company Act of 1940 provides in pertinent part:

(a) Subject to paragraph (b), no person shall solicit or permit the use of his name to solicit any proxy, consent or authorization in respect of any security of which a registered investment company is the issuer except upon compliance with the provisions of all rules and regulations adopted pursuant to the provisions of Section 14 (a) of the Securities Exchange Act of 1934 that would be applicable to such solicitation if such solicitation were in respect of a security registered on a national securities exchange.

Regulation X-14 promulgated by the Commission pursuant to Section 14 (a) of the Securities Exchange Act of 1934 provides in pertinent part as follows:

RULE X-14A-9. FALSE OR MISLEADING STATEMENTS

No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements herein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

No. 15,457

In the

United States Court of Appeals

For the Ninth Circuit

SECURITIES AND EXCHANGE COMMISSION,
Appellant,

VS.

INSURANCE SECURITIES INCORPORATED, et al.,
Appellees.

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No. 15457

In the

United States Court of Appeals

For the Ninth Circuit

SECURITIES AND EXCHANGE COMMISSION,
Appellant,

vs.

INSURANCE SECURITIES INCORPORATED, et al.,
Appellees.

**Brief for Appellees Insurance Securities Incorporated,
Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan,
Roy A. Haight and Leland M. Kaiser.**

This is an appeal (R. 152) from a judgment of dismissal (R. 151), rendered on a motion to dismiss an amended complaint (R. 52). *Securities & Exchange Commission v. Insurance Securities Inc.*, 146 F.Supp. 778. The suit was brought by an administrative agency seeking to enforce its own peculiar notions of public policy without the slightest basis in the statute on which it purports to rest. At the outset of the argument in the District Court we submitted "our view, that the plaintiff's foundation and basic contention is about as fantastic an assertion as has ever been presented in a court" (R. 157), and we make the same submission at the outset here.

STATEMENT OF THE CASE

The plaintiff and appellant is the Securities and Exchange Commission, hereafter called the Commission or the S.E.C. It purports to proceed under the *Investment Company Act of 1940* (15 U.S.C. § 80a-1, et seq.), hereafter called the Act or the statute.¹

The prime question in the case is simply this: Does anything in the statute prohibit the actions alleged in the complaint? Did Congress see fit to confer on the Commission any authority to seek from the courts condemnation of what was done or any jurisdiction on the courts to grant it?

A. The defendants and their relation to each other.

1. The Trust Fund:—The Investment Company.

There exists in Alameda County, California, a certain unincorporated "Trust Fund", created by a trust agreement in 1938 (R. 5, para. 5) with a San Francisco bank as trustee (R. 22). The assets of the Trust Fund are supplied by "investors" and in turn are invested by the Trust Fund in a variety of insurance company stocks (R. 5, para. 7). As the complaint correctly alleges (R. 5, para. 5, 6), the Fund is a "registered investment company" within the definitions of the Act.² While the Fund was named as a defendant, no charges were made against it, no relief was sought against it, and it never appeared in the action. Although it is named in the caption, in this Court, as one of the appellees, the terms "appellees" and "defendants" will be used in this brief to refer to the other defendants alone.

1. In this brief we shall cite the sections of the Act merely as "Section". The comparable section in Title 15 U.S.C. will ordinarily be prefaced by "80a". E.g., "Act, Section 3" will be found as 15 U.S.C. Sec. 80a-3, and "Act, Section 15" will be found as 15 U.S.C. Sec. 80a-15. Some sections of the Act bear a different number in 15 U.S.C. 80a, and when this is so, we shall also give the U. S. Code citation.

All emphasis in quotations in this brief has been added unless otherwise noted.

2. Act, §§ 3, 8. Section 3 states that an "investment company" is an "issuer". Section 2(a)(21) defines an "issuer" as every "person" who issues a security. Section 2(a)(27) defines "person" as including "company", and Section 2(a)(8) defines "company" as including a "trust, a fund".

2. ISI:—the Service Corporation.

Appellee Insurance Securities Incorporated is a California corporation organized in 1938 (R. 4, para. 1), and it will hereafter sometimes be referred to as "ISI". ISI has had a *contract* with the Fund, the latter acting by the vote of the investors. Under this contract ISI performed three types of services for the Fund: (a) It acted as a salesman to sell "Participation Agreements" in the Trust Fund to investors; (b) as investment adviser it selected the insurance stocks the Fund should buy; and (c) it performed administrative duties.

For convenience we shall refer to the contract between the Fund, on the one hand, and ISI, on the other, as the "service contract". We shall sometimes refer to ISI as the "Service Corporation"³ and to the duties performed by it under the contract as the "services".

As compensation for its several services ISI is paid certain fees as provided by the contract,⁴ which are of three types comparable to the three types of service. The bulk of the fees are called "creation fees" and consist of commissions paid for the sale of participations to investors (R. 6, para. 9). These sums are paid by a deduction from the amounts paid to the Fund by the individual investor (R. 31, 32, para. (e)). Of minor amount is an "administrative fee", and of even smaller amount is an "advisory fee", based on the net payments of investors (R. 6, 29, 30).

There is no question that a contract between a "service corporation" and an "investment company" for the performance of such services and the payment of the fees for services rendered is recognized by the Act (cf. pp. 12, 61, 64 below).

3. In the language of the Act, ISI is the "Sponsor, Depositor, Investment Adviser and Principal Underwriter" of the Fund (R. 5, para. 4). For convenience we shall refer to any corporation performing similar services as a "service corporation" and to any contract for similar services as a "service contract".

4. It may be observed that no contention is made that these fees are unfair in amount.

3. The individual defendants Leach, Lonergan, Carr and Haight:—Stockholders in the Service Corporation.

None of the individual defendants was, at any time referred to in the complaint, an officer, director or employee of the Trust Fund. Being a corporation, ISI has its own stockholders, and defendants Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan, and Roy A. Haight were some of ISI's stockholders and directors (R. 4, para. 2; R. 7, para. 14).

The remaining defendant, Leland M. Kaiser, is in still a different category and his position in this case is described at p. 16, *infra*.

4. Relationship of the parties to each other—the Chart.

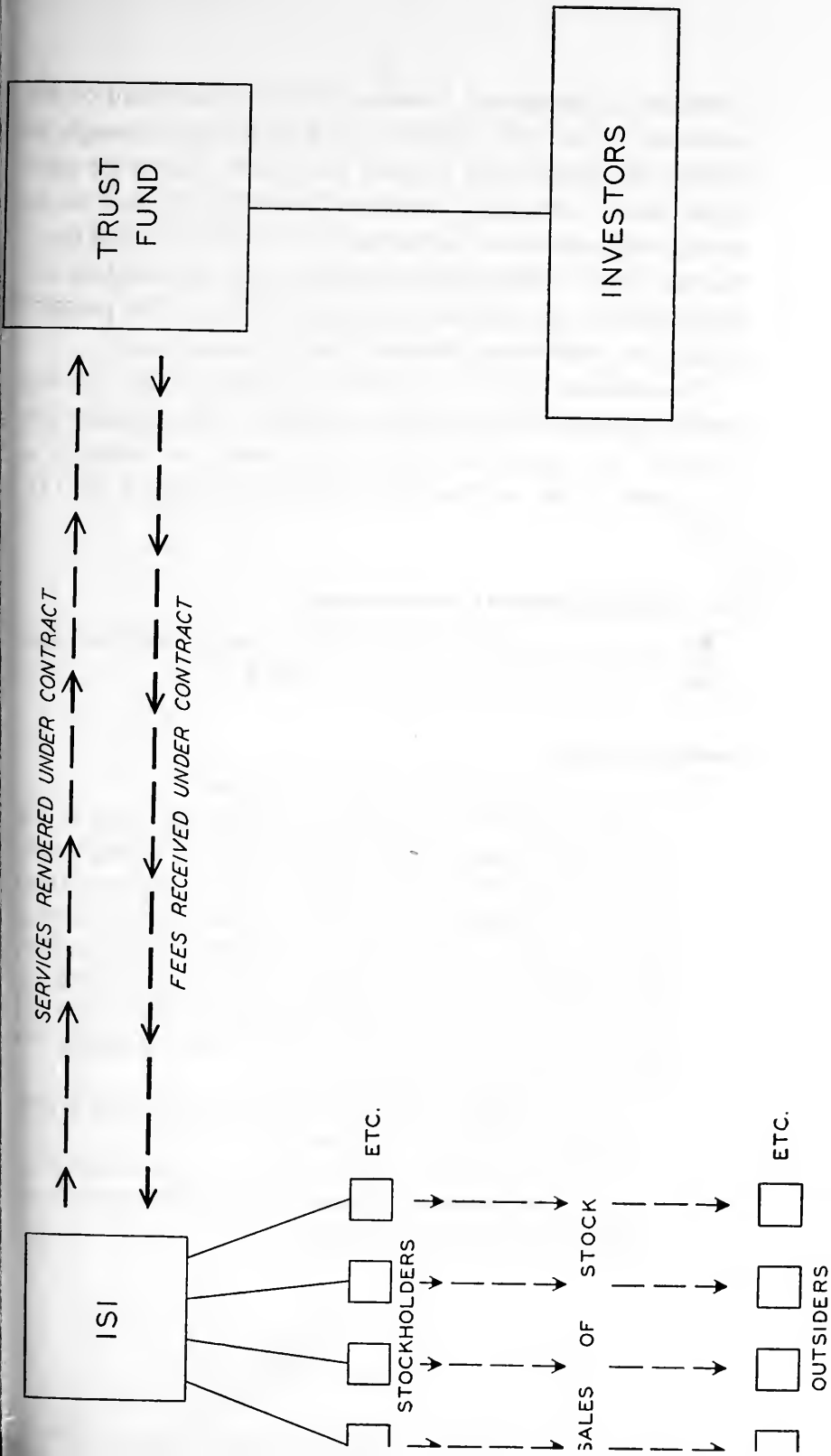
So that the relationship of the several parties to each other may be clear, we reproduce a schematic chart used in the argument below. The relationship may be summed up thus: Leach, Lonergan, Carr and Haight were stockholders in the corporation, ISI, and were several of its directors. ISI had a contract with the Trust Fund, whereby it performs services for the Fund and receives compensation. The Trust Fund is a fiduciary to its investors.

When in this brief we refer to "stockholders," we mean stockholders in ISI; by "investors" we refer to investors in the Trust Fund.

B. The proceedings below.

On August 13, 1956, the Commission filed its complaint in two counts (R. 3-47) and with only casual oral notice applied for a temporary restraining order.⁵ In view of the lack of adequate notice, defendants stipulated to a limited interlocutory restraining order, and the application for an injunction *pendente lite* was set down for hearing (R. 48-50). Thereupon defendants filed their

5. Appellant's brief loosely states that "On August 14, 1956, the Commission brought on for hearing its motion for a preliminary injunction * * *" (Br. 13). This is not a correct characterization of what happened.



"Motions to Dismiss and Dissolve" (R. 52), to be heard on the same date as plaintiff's application, and by that motion sought to dissolve the interlocutory restraint and also to dismiss the complaint. Before defendants' motions or plaintiff's application for an interlocutory injunction could be heard, a stipulated "Second Interlocutory Order" dissolved the restraining order and withdrew the application for an interlocutory injunction (R. 93). The proceedings for an interlocutory injunction thereby became moot.

The motion to dismiss was argued at great length (R. 155) and granted upon the allegations of the complaint, with an opinion (R. 142-150). The gist of the opinion is that there is no authority in any statute for the suit. An order of dismissal followed (R. 151, 152).

C. The claim asserted in the first count.

Count One is the main count of the complaint, and the Commission rests it entirely on Section 36 of the Act.

Section 36 of the Act.

Section 36 [15 U.S.C., Section 80a-35] provides:

"The Commission is authorized to bring an action in the proper district court of the United States or United States court of any Territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has been guilty, after August 22, 1940, and within five years of the commencement of the action, of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts:

"(1) as officer, director, member of an advisory board, investment adviser, or depositor; or

"(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If the Commission's allegations of such gross misconduct or gross abuse of trust are established, the court shall enjoin such person from acting in such capacity or capacities either permanently or for such period of time as it in its discretion shall deem appropriate."

No mismanagement or misappropriation is charged.

The gist of Count One is the claim that certain defendants had committed a "gross abuse of trust" or "gross misconduct" *with respect to the Trust Fund*. The very first sentence of the complaint so asserts (R. 3). It is therefore notable that, in response to a request for admission under R.C.P. Rule 36, the Commission admitted (R. 50, 89)

"that the action does not concern the investments in insurance stocks nor the portfolio of the Trust Fund, nor the manner in which Insurance Securities, Inc., has managed the funds invested in Trust Fund.

"The complaint does not allege that the defendants have mismanaged or misappropriated any of the assets of the Trust Fund."

As the District Court said in its opinion (R. 147):

"The complaint makes no charge of any misconduct or abuse of trust, gross or otherwise, with respect to Trust Fund or its investors. No claim has been made in the complaint or otherwise that the business of Trust Fund has not been conducted efficiently or honestly or that the investors of Trust Fund have suffered any loss or damage of any kind with respect to their interest in Trust Fund by reason of any act or conduct of Service Company, or its officers or directors."

And this statement is not challenged by appellant. Thus at the outset it is seen that in this case the Commission uses the term "gross abuse of trust", not in any normal sense, but in an esoteric sense of its own.

Sales by stockholders in ISI to outsiders of their stock in ISI.

The claim is that a "gross abuse of trust" occurred because the defendants Leach, Lonergan, Carr and Haight *sold some of their personally owned stock in ISI to third parties at certain prices.*

On January 1, 1956, each of these 4 individuals owned 30,000 shares of stock *in ISI* out of a total of 166,000 shares outstanding (R. 7, para. 14). The complaint alleges that thereafter, and prior to the institution of the action, by a number of sales at different times and to a number of different buyers, Leach, Lonergan, Carr and Haight each sold 13,000 shares (R. 9, para. 18).⁶ In July, defendant Leach entered into a contract to sell 16,000 additional shares (R. 59, 65, 67), to be consummated either on the day a new contract between the Trust Fund and ISI was approved by the investors or, if the new contract was rejected, then within 7 days after rejection (Exhibit B to Complaint, at R. 33; also R. 68). The sale had not been consummated when the complaint was filed. The first "Interlocutory Order" issued on August 14th restrained the voting by the investors, so that the consummation of the sale was prevented until a later date.⁷ Relevant data as to the number of different sales, the dates, the buyers and the like will be stated in the division of the argument below where it is pertinent (pp. 94-96, *infra*).

None of the purchasers in any of the sales is a defendant.

Like any service corporation, ISI's *physical* assets are relatively small, and the complaint alleges that the net asset value of its shares, as shown on the balance sheet, was \$1.81 per share (R. 9,

6. Following the practice of the complaint, the number of shares is here stated in terms of equivalents after a splitup (R. 7, para. 13).

7. The record shows that after dissolution of the restraining order on August 30th (R. 93), the investors approved the new service contract between ISI and the Fund (R. 140, 141). The record does not show whether the July contract by Leach to sell the 16,000 shares was then consummated, but we admit that it was.

para. 19). But as in the case of any service organization, physical asset value is no measure of worth, and the various sales in 1956 were made at the price of \$50 per share (R. 9).

The Commission points (Br. 7) to Section 2(a)(9) of the Act which provides:

"Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company shall be presumed to control such company. Any person who does not so own more than 25 per centum of the voting securities of any company shall be presumed not to control such company. * * *"

It then argues that the individual defendants—Leach, Lonergan, Haight and Carr—sold a "controlling block" of stock. *If* all the stock sold in 1956 by these four were deemed sold by one seller to one purchaser, there would have been a transfer of control of ISI, the "Service Corporation".

As we shall see (pp. 94-96, *infra*), the uncontradicted fact is that not a single stockholder of ISI owned as much as 25% of its stock, nor did a single stockholder sell all he had to one buyer. Not one had a controlling block to sell and no buyer bought as much as 25%. Consequently, in order to present its theory, the Commission found it necessary to aggregate all the sellers and all their sales, on the one hand, and all the buyers and all their purchases on the other. The manner in which it attempts to do this is described in Part Two of the argument relative to Count One (p. 97, *infra*).

Nature of appellant's claim.

Starting with the assumption that a "controlling block" of stock in ISI was sold, the Commission adds the fact that the price was \$50 per share. It is these two facts which the Commission contends constituted the alleged "gross abuse of trust"—not toward other stockholders of ISI—but toward the investors in the Trust Fund.

As we understand the contention, had the selling stockholders of ISI not been directors of that corporation, there would be no "gross abuse of trust" regardless of the number of shares sold or the price.⁸ This restraint in the Commission's contention is imposed on it by the fact that it rests its case on Section 36 of the Act. By its terms Section 36 is limited in scope. It applies only to the investment adviser or principal underwriter of an investment company and to one who is a director or officer of the investment company. And the remedy it prescribes is an injunction against activity in one of the prescribed categories. Even the Commission cannot find in Section 36 any basis to reach stockholders of an adviser and underwriter, if they are not directors or officers and *occupy no office subject to an injunction*.

In consequence, in fashioning its theory on Section 36, the Commission reaches a curious result (Cf. App. Br. 68):

1. A stockholder of a service corporation who is not a director may sell any number of shares at any price whatsoever.

2. A stockholder who is also a director may sell a block of 25% or less of the stock for any price, however large, but he may not sell a block of more than 25% for more than asset value.

3. A director who owns all the stock may sell it all in equal blocks to 4 unrelated buyers at any price per share, but he may sell to 3 unrelated buyers in equal amounts only at physical asset value.

4. A director may give or bequeath any amount of his stock to whomever he pleases.

In the Argument to follow we shall ask the Court to draw the obvious conclusion that an attempt to deduce a regulation of the price at which stock in a service corporation may be sold, and to work the odd distinctions noted above, from a section of the Act

8. As the complaint alleges (R. 9, para. 18), 20,000 shares of ISI stock were sold by several others who were not directors, and no claim is made against them.

that neither refers to directors or stockholders of *that* company nor speaks of sales or prices, is fantastic.

The nature of the Commission's claim, as asserted in Count One, may further be characterized from its allegations and admissions as follows:

1. The transactions—the sales of stock *in* ISI by *its* stockholders—were “transactions * * * with outsiders and *not with the Trust Fund*”.⁹ *That is, here is no case of those in control dealing with their beneficiaries;*

2. There was no transaction between the Trust Fund and the Service Corporation. No defendant bought anything from, or sold anything to, the Trust Fund;

3. “There was no diversion or use of trust assets”;⁹

4. ISI did not waste the assets of the Trust Fund;

5. It did not mismanage the Trust Fund (R. 89);

6. It did not appropriate any of the assets of the Trust Fund (R. 89); and

7. Appellant is “not suggesting that the new controlling interests in ISI will abuse their fiduciary position with respect to the Trust Fund” (App. Br. 80).

The claim against defendant ISI.

ISI, the corporation, was not a seller of any stock. While it was named as a defendant in the caption (R. 3), the original complaint nowhere charged it even with the conclusion of misconduct or abuse of trust. The opening sentence of the original complaint read thus (R. 3):

“It appearing that the *defendant individuals* named hereinafter have engaged, and may continue to engage, in acts and practices which constitute gross misconduct and gross

9. The quoted words come from appellant's brief in the District Court; it has pruned its brief in this Court of a number of such candid statements.

abuse of trust within the meaning of Section 36 of the Investment Company Act of 1940 ('the Act'), 15 U.S.C. 80a-35; * * * the Securities and Exchange Commission ('the Commission') brings this action to enjoin such acts and practices and further violations of the Act and the Commission's Rules and Regulations thereunder, and for other appropriate and equitable relief."

And the climactic (although conclusory) allegation of the original complaint read thus (R. 11, para. 25):

"By reason of the foregoing, the *director-defendants* are guilty of 'gross misconduct' and 'gross abuse of trust' within the meaning of Section 36 of the Act."

It was only as an *afterthought*, by an amendment to the complaint (R. 47), that these two passages were amended to insert the words "Insurance Securities Incorporated and" before the words "the defendant individuals named hereinafter" in the first sentence and to make a similar addition in Paragraph 25. But while the complaint was amended to add the legal conclusion, it was not amended to allege that ISI had done any acts. Furthermore, no final relief was prayed for against ISI in the original complaint, that prayer being added by amendment (R. 47, 48).

D. Execution of a new service contract and other material events in September 1956.

Section 15 of the Act requires any service contract to provide for its automatic termination upon any assignment. In conformity with the Act, the Service Contract between ISI and the Trust Fund provided for such automatic termination (R. 6, 7, para. 11). Section 2(a)(4) of the Act provides that an "assignment" is deemed to include

"any direct or indirect transfer * * * of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; * * *"

If the various sales of ISI stock which occurred or were contracted for prior to the suit constituted a transfer of a controlling block, then the service contract terminated. Because of the possibility that it might be deemed that a transfer of control of ISI had occurred, ISI notified the investors in the Trust Fund that the transfers may have terminated the contract, and it placed before them for vote the question whether the contract should be reinstated. Proxies were solicited for the purpose of voting on this subject. The proxy solicitation material is attached to the complaint (Ex. B; R. 18-47).

The question of reinstatement of the service contract was to be voted upon on August 15, 1956. But this suit was filed on August 13th, and on August 14th the first Interlocutory Order restrained the voting of the proxies on this matter until further order of the court (R. 48). The restraint was dissolved on August 30th by the Second Interlocutory Order (R. 93), and on September 14, 1956, at an adjourned meeting, the investors voted to reinstate the service contract (R. 141). On September 17th, pursuant to this authorization, a *new* service contract between ISI and the Trust Fund was entered into (R. 141).

Creation of a Board of Directors for the Trust Fund.

Prior to September 17, 1956, the unincorporated Trust Fund had no Board of Directors (R. 6, para. 8). But, as stated in the opinion of the District Court (R. 143), "Since the commencement of the action, Trust Fund has, by amendment to its bylaws, authorized the creation of a Board of Directors of its own."

At the very time that the question was submitted to the investors whether the service contract should be reinstated, there was also submitted to them, with the same proxy statement, an amendment to the Trust Agreement establishing a separate Board of Directors for the Fund. The letter to the investors forwarding the proxy statement said (R. 19):

"The amendments to be acted upon involve (a) the creation of a Board of Trustees or Directors for the Fund, to be elected by the Investors, to whom Insurance Securities Incorporated will be responsible in its Investment Advisory and Underwriting functions * * *."

The proxy statement said (R. 24) :

"In order that the Trust Fund may be managed by a Board elected by the Investors and directly responsible to them, it is proposed that the Trust Agreement be amended so as to provide for a board of trustees to be known as the 'Board of Directors' which would be entrusted with the management of the business and affairs of the Trust. Duties heretofore performed by the Company would thereafter be performed by it, subject to the control, supervision and direction of the Board of Directors."

This proposal came before the investors on August 15, 1956, since the first Interlocutory Order did not enjoin voting on it (R. 48). It was adopted, and it was put into effect on September 17th (R. 140, 141). The present existence of the Trust Fund's own Board of Directors is recognized throughout appellant's brief (e.g., pp. 5, 11, 42 (fn. 31)).

E. The claim asserted in the second count of the complaint.

Count Two of the complaint was a mere appendage or afterthought, contrived to support Count One and to permit the application for interlocutory relief. Count Two was the sole basis of all interlocutory relief sought by appellant.

As just noted, ISI solicited proxies and Count Two sought to enjoin the voting of the proxies. Its gravamen is stated in paragraph 29 (R. 12) :

"The aforesaid proxy solicitation material is false and misleading and in violation of Section 20(a) of the Act and Rule N-20A-1 (17 C.F.R. 270.20a-1), which incorporates by reference and makes applicable to registered investment

companies the Commission's proxy rules set forth in Rule X-14A (17 C.F.R. 240.14)."

Since the proxies were voted after the interlocutory restraint was dissolved on August 30th (R. 93), and since the final decree terminated the remaining restraints of the Second Interlocutory Order (R. 152), everything Count Two sought to enjoin has since occurred.

Appellant concedes that Count Two is dependent on Count One, and that if Count One fails Count Two also fails (R. 161, 162; Br. 15, 105).¹⁰ However, Count Two possesses its own independent deficiencies, which will be discussed in Part Two of the Argument (pp. 105 et seq., *infra*).

F. The relief sought by the complaint.

Other than interlocutory relief, which is now moot, the amended complaint prayed for the following relief only:

1. An injunction against the individual defendants serving as officers and directors of ISI or of the Trust Fund (Prayer 1, R. 14);
2. "That an accounting be rendered by the director-defendants in this cause for the inequitable and wrongful profits realized, and to be realized, as a consequence of the sale of their stock of Insurance Securities Incorporated" (Prayer 5, R. 15). Under this prayer it seeks a decree compelling defendants Leach, Lonergan, Carr and Haight to pay to the Trust Fund about \$3,276,920, being the difference between the \$50 per share they received for the stock and the \$1.81 per share of physical asset value (e.g., Br. 12).
3. An injunction against ISI's "acting as investment adviser and principal underwriter of the Trust Fund" (Prayer 1, as amended, R. 47). Under this amended prayer appellant seeks to abrogate the *new* service contract, which the Investors authorized by their vote on September 14, 1956, and to enjoin ISI from hereafter serv-

10. Br. 15:—"This cause of action was dependent on the first".

Br. 105:—"the alleged proxy violation was expressly dependent upon the cause of action under Section 36."

ing as the investment adviser and principal underwriter for the Trust Fund (E.g., Br. 13).

In short, it seeks both to deprive the sellers of the purchase price and to punish the corporation because of the sales, thus also punishing the buyers and the other stockholders who had no part in the transactions which appellant assails.

Appellant nowhere specifies what final relief is now sought under Count Two.

G. The situation as respects defendant Leland M. Kaiser.

Defendant Leland M. Kaiser was made a defendant in a limited capacity. The caption of the complaint designates him as "Leland M. Kaiser as Attorney and Proxy for investors of Trust Fund" (R. 3), and the complaint alleges (R. 4, para. 3) that "He is made a party defendant herein in his capacity as proxy and attorney on behalf of investors of a 'Trust Fund' * * *."

Count One does not purport to state a claim for relief against him. It charges no act by him and no wrongdoing, and it seeks no relief against him.

Mr. Kaiser was joined as a defendant only because Count Two sought to enjoin the voting of proxies, and he was one of the proxy holders. Since the proxies were voted after the interlocutory restraint was dissolved (App. Br. 110), the action against him is moot, for, if any relief were now possible under Count Two, it could be granted without his presence. We think this so self-evident that the Argument will contain no separate discussion concerning Mr. Kaiser.

H. The function of the affidavits, and appellant's departures from the record.

Nine affidavits were filed in support of defendants' motion to dismiss the complaint and dissolve the interlocutory order (R. 55-

87). These were primarily directed to the issue whether the interlocutory restraint should be extended, as sought by the Commission, or dissolved, as requested by defendants. But the motion to dismiss stated that it might also rely on the affidavits (R. 53) and, to the extent that it did so, it would become a motion for summary judgment under R.C.P. Rule 12(b). Of course, the function of affidavits on an application for, or a motion to dissolve, an interlocutory injunction is much broader than on a motion to dismiss. On the former the affidavits are evidentiary, and the court may weigh and choose in order to resolve factual issues. On the latter the affidavits may be examined only to determine whether a genuine issue of fact exists on a material issue. When the proceedings for interlocutory relief became moot, the affidavits assumed the more limited function.

Consequently, at the hearing on the motion to dismiss, defendants advised the court that:

(1) Primarily, they accepted all allegations of fact in the complaint for the purpose of the motion, without any reference to the affidavits, and submitted that as a matter of law no claim for relief was stated,¹¹ and

(2) that, as a separate and independent reason for dismissing the complaint, they would refer to the affidavits, but, even so, only for certain uncontradicted objective facts.¹²

As shown in the Questions Presented (p. 20, *infra*), two main but independent reasons for dismissal of Count One are discussed by us. The District Court based its decision on the first, and this

11. R. 158-59. Defendants' counsel said: We "take the fundamental position that taking Count 1 just on its face, accepting all its allegations of fact, it doesn't state a claim for relief" (R. 158)

The complaint is replete with conclusions of law and, naturally, the motion did not admit them. They will be referred to in proper context in the argument *infra*.

12. R. 158-59. Defendants' counsel said: "* * * I assure your Honor, I don't intend to ask your Honor to decide any factual questions upon affidavits. But there are certain uncontradicted objective facts * * *"

A tenth affidavit (R. 140), filed by appellees, was of this nature.

accepts the allegations of the complaint and does not rest on any affidavits. The second refers to the affidavits but only for certain uncontradicted objective facts.

Much of the material in the affidavits related to the proxy matter, which is the subject of Count Two,¹³ in that they bore on whether the Commission's staff had led ISI to believe that the proxy material, which had been submitted to the staff for inspection, was satisfactory. Defendants contended that the material showed that ISI had issued the proxy material in good faith. Since good faith would be pertinent to the kind of relief that would issue *if* a final decree were to go against defendants, it was relevant to the application for an interlocutory injunction. But that phase of the case became moot with the entry of the Second Interlocutory Order. The issue now is simply whether a claim for relief is even stated by Count Two. That, in turn, is simply the question whether the proxy solicitation material violated the S.E.C.'s proxy rule. And that is a question of law determinable on the face of the complaint to which the proxy solicitation material is an exhibit (R. 18-47). Therefore we shall discuss Count Two on the basis of the allegations of the complaint alone and shall ignore appellant's discussion of the affidavits.

In view of the foregoing, it is curious that appellant's Statement of the Case (Br. 3, et seq.) meanders through the affidavits. Uncontradicted facts may pierce as sham an otherwise good complaint. But a complaint that states no claim for relief in its very fundamentals cannot be made good by resort to affidavits. No resort to affidavits can repair the total absence of statutory foundation.

Even more curious, not to say contrary to proper practice and entirely without justification, is appellant's resort to purported facts *wholly outside the record*. Thus it indulges (Br. 78, 79) in

13. Part III of Haight's Affidavit, R. 76, and three affidavits filed by the appellant, R. 97, 104, 136.

a little narrative about an "uncontested case" the Commission had with the estate of one Gardiner. We shall briefly comment on this matter at p. 102, fn. 12, *infra*. Appellant also attaches to its brief two pretentious but empty appendices (B and C) supposed to be data about numerous investment companies, all compiled from the Commission's files and a variety of other "sources available to us" (i.e., to the Commission) (Br. 54). None of it is in the record; none is of the type of which a court can take judicial notice. There are perhaps 100,000 or more Commission files in which data of this kind may appear.¹⁴ And as a matter of pure chance appellees' counsel can state of their own knowledge that some of the alleged data is erroneous,¹⁵ which necessarily casts doubt on the reliability of the appendices. Moreover, these appendices are obviously incomplete on their face, even on the matters on which they purport to give information.¹⁶

Were not these extra-record statements utterly irrelevant to this case, we would vigorously object to this method of arguing a case on appeal. As it is, we shall ignore them.

14. Specifically, there are 57 companies listed in Appendix B, and it is stated that the information is obtained from the annual reports, proxies, prospectuses and registration statements of such companies. That would require the examination of at least 228 files to verify the data. Appendix C covers 150 companies and would require the examination of at least additional 150 files, a total of at least 378 files.

15. For example, the principal underwriter for Chemical Fund, Inc. is a corporation and not a partnership and is the same corporation which is its investment adviser; Tri-Continental Financial Corporation is not, and never was, the investment adviser to Broad Street Investing Corporation, nor to National Investors Corporation, nor to Whitehall Fund, Inc.; Broad Street Sales Corporation is not owned by Tri-Continental Corporation; Broad Street Sales Corporation does have other business than that of acting as principal underwriter for the three investment companies named; de Vegh & Company is not, and never was, the principal underwriter for de Vegh Investing Company, Inc., which, indeed, has no principal underwriter.

16. For example, information is given only as to ownership of 10% or more in some cases and 25% or more in other cases.

THE QUESTIONS PRESENTED

I. With Respect to Count One.

Question 1: Assuming that Leach, Lonergan, Haight and Carr sold a "controlling block" of stock in ISI, nevertheless is any claim for relief stated either against them or ISI? In other words, does the Act regulate the sale by any stockholder of his stock in a service corporation or limit the price? Our basic submission is that it does not, regardless of the number of shares sold. And this is what the District Court held.

Question 2: Does the complaint allege that there was the sale of a "controlling block", and, if it does, has not this allegation been pierced by an uncontradicted factual showing as sham?

II. With Respect to Count Two.

It is conceded that Count Two fails if Count One fails. In addition:

Question 1: Is not Count Two moot in any event?

Question 2: Regardless of Count One, is it not plain on the face of the complaint that there was no violation of the Proxy Rules and that Count Two is frivolous?

SUMMARY OF THE ARGUMENT

I. With Respect to Count One.

A. Count One states no claim for relief, even if a controlling block of ISI stock were sold.

1. A transaction otherwise legal cannot be outlawed or denied its usual business consequences unless banned by Congress. *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 92. But Congress has not, by any express provision in the Investment Company Act, purported to prohibit the sale of stock in a service corporation or to regulate the price at which it may be sold. Congress was concerned with transfers of control of investment companies without the consent of the investors, and prescribed as the remedy that any transfer of a service contract or of the

control of a service corporation terminates the contract, leaving it up to the investors to reinstate the contract or not (Act, Sections 1(b) (6), 15(a), and 2(a) (4)). This is the only protection Congress thought it necessary to give the investors. In view of these express provisions, it is fallacious to talk about sale of "control" of an investment company. No such sale can occur or can ever be effected by transfer of controlling shares in the service corporation. (pp. 28-30, *infra*).

2. Lacking specific statutory support, appellant relies entirely on Section 36. But that section has nothing to do with the subject, and appellant cannot make it do so by resort to "legislative history". The Act is so detailed and precise that it precludes enlargement by implication. *Doyle v. Milton*, 73 F. Supp. 281; *Addison v. Holly Hill Co.*, 322 U.S. 607, 617; *Howard v. Furst*, 238 F.2d 790 (2 Cir.), *cer. den.* 353 U.S. 937. Furthermore, the Act was a compromise measure agreed on between the Commission and the investment company industry. In the Act as passed, Congress avoided broad standards and delegations of discretion and substituted detailed and explicit prescriptions, demonstrating that when Congress meant to regulate or prohibit it did so explicitly. (pp. 31-42, *infra*).

3. The essence of appellant's position is that it is not satisfied with Congress' answer to the transfer problem, lacks Congress' faith in the competence of the investors to pass on reinstatement of contracts, and belittles Congress' remedy. But when Congress provides a remedy, no one may enlarge it by belittling what Congress has done; the scope of a statute may not be extended beyond the point where Congress has indicated it should stop. 62 *Cases of Jam v. United States*, 340 U.S. 593; *Wilder Mfg. Co. v. Corn Products Co.*, 236 U.S. 165, 174; *Bruce's Juices v. American Can Co.*, 330 U.S. 743; *Switchmen's Union v. Board*, 320 U.S. 297, 301. (pp. 42-47, *infra*).

4. Nor can appellant draw its contentions into Section 36 from any principle respecting fiduciaries. To say that a man is

a fiduciary only begins analysis. One must ask to whom is he a fiduciary, what obligations he owes as such, and wherein has he disregarded his obligations. *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 85. While ISI was a fiduciary to the Trust Fund, this did not make it a fiduciary in everything it did, and did not make the stockholders of ISI fiduciaries to the Fund with respect to their stock in ISI. This case involves no self-dealing; no transaction between fiduciary and beneficiary; no diversion, use, waste, appropriation or mismanagement of trust assets; no abuse of fiduciary position with respect to the Trust Fund. (pp. 47-49, *infra*).

"Gross abuse of trust" and "gross misconduct" as used in Section 36 refer to self-dealing, that is, transactions between officers, directors and similar persons, on the one side, and investment companies with which they are associated, on the other. These terms were intended to cover such substantial deviation from the obligations of trusteeship as show that the person cannot be entrusted with the management of other people's money (Hearings of the Subcommittee of the Committee on Interstate and Foreign Commerce, 76th Cong., 3d Sess., on H.R. 10065, p. 59; *Aldred Investment Trust v. S.E.C.*, 151 F.2d 254). And this is confirmed by the fact that Section 36 does not speak of "abuse of trust" but of "gross abuse of trust". (pp. 49-54, *infra*).

Every contract between two parties has two values, one to each party. The value of a service contract to the investment company lies in the fact that it obtains services. The value to the service corporation lies in the fees received. The purchaser of stock in a service corporation may entertain a hope that the investors in the investment company will reinstate the service contract terminated by the sale, but if any value attaches to that expectation and thus to the hope of future fees, it belongs to the service corporation's side of the contract. Thus there is no trading in a trust asset. As the investment company must continue to pay fees, the sale of the service corporation's stock by a stockholder

therein to another person takes away from the investors in the investment company not one cent nor adds one cent to their expense. (pp. 54-57, *infra*).

Corporate fiduciaries who perform services for an agreed fee are common in American law and business, and they are entitled to make a profit. Their stock is freely bought and sold, and like the stock in many corporations the value is fixed in relation to expected earning power. It has never been held that this value is an asset of the beneficiaries who pay the fees that form the earnings. (pp. 57, 58, *infra*).

According to appellant, a sale of stock in a service corporation disregards a fiduciary obligation because of a "conflict of interest" in seeking a price greater than would be obtainable if the service contract were rewritten to reduce the service fees. But there is no duty on the part of a fiduciary to reduce the agreed fees. Any reasoning that would support such a duty would also limit the stockholders in a service corporation to insignificant dividends. In essence, appellant is seeking to set itself up as a rate-regulating agency to fix a service corporation's fees indirectly. But Congress has conferred no such power on the Commission or the Court. (pp. 59-61, *infra*).

Appellant is illogical when it speculates that a price based on earnings induces hazardous policies. The greater the price, the more it is to the interest of the stock purchaser for the service corporation to serve the investment company successfully so as to continue to earn compensation. This is particularly true of ISI, whose fees are based solely on the amount of investors' money attracted into the Fund and not at all on transactions in, or manipulations of, the Fund. (pp. 61-63, *infra*).

The analogy of a sale by the trustee of his office, which appellant tenders, is false. A trustee cannot sell his office at all, but Congress recognized that a corporation may act as an investment adviser and underwriter and that its stockholders may sell their

stock. This is inherent in the concept of a corporate fiduciary, as appellant admits. (pp. 63-65, *infra*).

Appellant's other citations are not relevant. The general rule is that the holder of a controlling block of stock may sell for the best price available, enhanced by the control position of his shares. To this rule appellant's citations merely note exceptions in the case of "looting", misrepresentation, or other special situations. And this subject is not relevant, because it relates to the duty of those in control of a corporation to the corporation itself or to the minority stockholders therein. No case suggests that majority shareholders owe any duty with respect to their shares to outsiders with whom the corporation has a contract. (pp. 65-71, *infra*).

Moreover, under the particular facts of the present case, there is no possibility of any control of the Trust Fund by the purchasers of ISI shares because the Trust Fund now has its own independent Board of Directors. (pp. 71, 72, *infra*).

5. ISI committed no conduct complained of, for that conduct was the sale of stock in ISI, and it was the conduct of the individual stockholders. A "reverse disregard of corporate entity" is not possible because not all the stockholders committed any act claimed to be misconduct, and what was done was done with respect to individual property and not on behalf of the corporation. (pp. 73-77, *infra*).

6. Section 36 is unique and unlike any other section of the Act. As originally proposed, it made acts of gross abuse "unlawful" and hence subject to penal sanctions under Section 49 and to any appropriate civil remedy at the suit of the Commission under Section 42(e). But it was deliberately rewritten by Congress, so as to grant a specific remedy for gross abuse, limited to an injunction against continuance by the guilty person in the capacity in which he committed it. (pp. 78-81, *infra*).

Hence the Commission has no power to seek an accounting of profits made by the sellers of stock. Hence, also, no court has jurisdiction to grant an accounting at the suit of the Commission,

for the Commission is not an injured party entitled to invoke the full scope of an equity court. It is merely an agency of the government, empowered by Congress to seek a specific remedy and confined within the limits of the Congressional grant. (pp. 81-84, *infra*).

Furthermore, the nature of the remedy under Section 36 demonstrates that the Section has nothing to do with sales of stock in a service corporation. The remedy provided by Congress illustrates the evil it sought to remedy. If transfer of control of a service corporation were deemed to be a gross abuse of trust under Section 36, the only remedy available would consist of ousting the individuals from office and would thereby effectuate the transfer of control. This would be paradoxical. (pp. 84, 85, *infra*).

7. In fact, the individual defendants do not come under Section 36 at all. That section does not relate to persons in all capacities fiduciary to an investment company but solely to *certain* capacities and then only "in respect of" an investment company. The capacities are (a) investment adviser, depositor and principal underwriter of an investment company, and (b) officer or director of an investment company or member of its advisory board. ISI, and not the individuals, is the investment adviser, etc., of the Trust Fund. And the individuals are not officers or directors of the investment company—the Trust Fund—but of ISI. They occupy no capacity to which Section 36 relates.

So far as officers of a service corporation act for it in respect to its duties under the service contract to the investment company, their acts are its acts and can fall under Section 36. Acts as individuals, such as buying or selling to the investment company, are specifically prohibited by other sections of the Act. But acts in their individual capacity of selling their personal property to outsiders come within no section.

The plain English of Section 36 thus confirms the conclusion that it was never intended to reach sales by stockholders of their stock in a service corporation. (pp. 86-93, *infra*).

B. There has been no transfer of a controlling block of stock of ISI.

Appellant's theory assumes that there was a sale of a controlling block of stock in ISI, and in part I we accept this assumption. But it is incorrect.

A "controlling block" means more than 25% of the stock (Act, Section 2(a)(9)). In order for there to be a transfer of a "controlling block", someone must sell more than 25% and someone must buy more than 25%. The matter must be looked at both from the seller's side and the buyer's side. But it is undisputed that no stockholder sold or even owned that much. Conversely, the transfers were made, not to 1, but to 7, none of whom acquired anywhere near 25%. Consequently appellant's brief seeks to aggregate all the sellers and all the buyers. Paragraph 16 of the complaint is the only allegation possibly bearing on that effort (quoted at p. 97, *infra*). But (1) this does not allege that the sellers acted in concert with each other; (2) even if it did, it would not bring this case within the Act's definition of a controlling block, and (3) it does not take account of the buyers' side. While it alleges that the sellers planned to sell to buyers "affiliated among each other through stock ownership and otherwise", the uncontradicted fact is that 4 of the 7 buyers are not affiliated with each other or with the other 3 by stock ownership or in any other way in which affiliation is defined by Section 2(a)(2) and 2(a)(3) of the Act, or in any other way. And the three affiliated buyers acquired in the aggregate less than 25%. (pp. 94-104, *infra*).

II. With Respect to Count Two

A. Count Two is moot.

The purpose of Count Two was to enjoin voting of the proxies, but they have all been voted. No relief by way of abrogating the contract authorized by the vote is available under Count Two. In any event, if appellant is correct in its contentions with respect to Count One, it will obtain that relief there, and Count Two is a superfluity. (pp. 105-106, *infra*).

B. There was no violation of the Proxy Rule.

The applicable Proxy Rule forbids (a) the affirmative but false statement of a material fact, and (b) the omission "to state any material fact necessary in order to make the statements therein not false or misleading." The complaint claims one affirmative misstatement and three items of omission.

The supposed misstatement is that, when ISI informed the investors that "a termination of the [service] contract takes place upon its assignment" and that the "stock sales may be considered an assignment" and therefore solicited the proxies *as if* the contract had in fact terminated, it should have stated that the contract had terminated! This is a frivolous contention, because the difference between what was said and what appellant claims should have been said is the difference between tweedledum and tweedledee. (pp. 106-110, *infra*).

The alleged omissions are the absence of a statement of the price at which the ISI stock was sold, its net book value per share, and the sellers' profits, and the omission to state that ISI had been advised by the staff of the Commission that the change in majority ownership "may also involve gross misconduct and gross abuse of trust under Section 36." Appellant admits that no affirmative statement in the proxy material was a half-truth or misleading because of any of these omissions. Its claim is, simply, that there was "a failure to disclose material information". But the only omissions the Proxy Rule reaches are of facts necessary in order to make affirmative statements not false or misleading. Its provisions are limited to "half-truths" and do not require the soliciting party to state every fact that one "might like to know or that might, if known, tend to influence his decision" (p. 113, *infra*). Moreover none of the omitted facts was relevant to the issue at hand, reinstatement of the contract. (pp. 110-114, *infra*).

PART ONE OF THE ARGUMENT

Discussion of Count One

I.

COUNT ONE OF THE COMPLAINT STATES NO CLAIM FOR RELIEF, EVEN ASSUMING A SALE OF A CONTROLLING BLOCK OF STOCK IN ISI

Rebuking the Commission in *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, the Supreme Court said (p. 92)

"* * * But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority."

Under the Act Congress has not delegated any authority to the Commission to lay down any standards on the subject of this case. The simple basic question is therefore this: Has Congress itself purported to regulate the price at which one may sell stock in a service corporation or to prohibit the sale in any circumstances?

A. The Act Does Not Purport to Regulate the Sale of Stock in a Service Corporation Like ISI, or the Price at Which It May Be Sold.

The Act contains no provision which prohibits sales of stock in a service corporation or which limits the price at which stockholders in such a corporation may sell their stock. This first and notable fact appellant is compelled to admit.

1. The express provisions of the Act provide a different kind of treatment, viz., termination of the service contract.

Section 1(b) of the Act states the "national public interest and the interest of investors" which the Act is designed to protect. The

relevant subdivision is (6), which declares that the national public interest and the interest of investors are adversely affected:

"when investment companies are reorganized, become inactive, or change the character of their business, *or when the control or management thereof is transferred, without the consent of their security holders;*".

In short, the concern of the Act was that when the control or management of an *investment company* is transferred, the *security holders shall have the right to approve or reject*. To this end there is a *specific provision*. As already noted (p. 12, *supra*), Section 15 requires that any assignment of a service contract automatically terminate it, and Section 2(a)(4) provides that an "assignment" is deemed to include a transfer "of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor * * *."

Thus *the* protection of the Act with respect to transfer of control of a service corporation, and the only provision on the subject, is that the service contract shall terminate, and thereby any question of its renewal must be placed before the investors in the investment company for their determination.

In this case, the protection which Congress provided was enjoyed. As we have seen (pp. 12, 13, *supra*), because of the possibility that it might be deemed that a transfer of control had occurred, ISI did notify the investors in the Trust Fund and placed before them the question whether the contract should be reinstated, and they voted for its reinstatement.

2. No transfer of control of an investment company is possible through transfer of control of a service corporation.

Hence, at the very outset we may sweep aside a fallacy which pervades appellant's brief. Repeatedly it makes statements that the individual defendants have sold "control" of the Trust Fund, or the "fiduciary relationship", or the "agreement between the

investment company and its investment adviser" (e.g., p. 52). If a controlling block of ISI stock was transferred, the effect may have been to change *the control of ISI*.¹ But a transfer of control of ISI was not, and could not be, a transfer of control of the Trust Fund, for its automatic effect under the Act was to *terminate* the contract between ISI and the Trust Fund. *Additional* action was necessary to affect the Fund:—the affirmative vote by the investors whether to enter into a new contract with ISI.

Appellant knows this to be so; when its attention is not riveted on the artificialities of its argument, its brief admits these facts. For example:

"* * * these agreements are not assignable by the investment adviser or principal underwriter, and, indeed, are automatically terminated upon their assignment." (Br. 18)

" 'The provision [Section 15] says that the management contract is personal, that it cannot be assigned * * *.' " (Br. 45)

"* * * the Act is both emphatic and inclusive * * * not only that the fiduciary arrangements between an investment company and its investment adviser or principal underwriter are not assignable but also that in the event of an assignment, the fiduciary relationships themselves are automatically terminated." (Br. 66)

"Existing contracts therefore cannot be assigned with or without approval of investors." (Br. 70)

3. No implied provision of the Act prohibits sale of a controlling block of stock in a service corporation or regulates the price at which it may be sold.

Lacking specific statutory support, appellant relies entirely on Section 36 of the Act (quoted, p. 6, *supra*). But that section says nothing about the sale of stock in a service corporation. It merely

1. If any duties in the premises were owed to anyone, they were owed to the minority stockholders of ISI. The latter make no complaint, appellant makes none on their behalf, and they were given the same opportunity to sell their stock as those who sold (see p. 101, *infra*).

authorizes the Commission to sue (a) for a certain limited kind of injunction against (b) persons in certain limited classes in the event (c) they commit "gross misconduct or gross abuse of trust". And nothing in the Act confers on the Commission any power to define "gross misconduct" or "gross abuse of trust." The meaning of these terms is a judicial question, a matter of statutory construction.

Congress *explicitly* dealt with the matter of transfers of control of a service corporation by Section 15. As we shall see (pp. 49-54, *infra*), Section 36 was aimed at a different matter entirely. Appellant asserts (Br. 31) that "Section 36, far from being a postscript or statutory aside, performs a vital function in the regulatory scheme of the Act." No doubt it does, but this does not mean that the carefully drafted provisions of the Act are to be ignored and that the general terms in Section 36, "gross abuse of trust" or "gross misconduct," are to be used as a vehicle of complete regulation, overriding, changing and dominating the remainder of the Act.

Appellant seeks to conjure up a prohibition or regulation of sales of stock in a service corporation to outsiders by two types of incantation:

1. It tries to find it in "legislative history", thus founding the regulation on a supposed *real* legislative intention of Congress, albeit never expressed.
2. It tries to find it in general principles of equity jurisprudence, thus founding the regulation not on any intention of Congress but on a sort of delegation by Congress to the courts.

An examination of each approach will demonstrate the contrary of what appellant contends.

B. The Legislative History Does Not Support, but Destroys, Appellant's Contention.

For want of any help in the Act, appellant resorts to a review of its *supposed* background, makes gratuitous assertions about the

"policy" of the Act, and from this seeks to rewrite the Act into the form which the S.E.C. would now enact *if* it were Congress.

There is a proper use of legislative history in the construction of a statute. Thus "changes made in the frame of the bill during the course of its passage" aid construction, *United States v. St. Paul, M & M. Ry. Co.*, 247 U.S. 310, 318. And in the following pages we shall point to two such changes of a highly significant character. So also the formal reports of the House and Senate Committees may sometimes be referred to legitimately.

But there is an improper use of so-called legislative history, including quotations from partisan reports or from witnesses before Congressional committees, of which appellant's brief is guilty (see *Pacific Ins. Co. Ltd. v. United States*, 188 F.2d 571 (9 Cir.)).² When a statute emerges from Congress, it is usually the end result of pulling and hauling, and preliminary arguments and testimony are either inadmissible or of trifling value in showing what Congress intended. As said in *Ex Parte Collett*, 337 U.S. 55, at 61:

"The short answer is that there is no need to refer to the legislative history where the statutory language is clear. 'The plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction.'"³

2. This Court there said (p. 572):

"The new legislative history referred to is an isolated excerpt from a statement made by a witness before the congressional committee considering the legislation. As such, in our opinion, it is not entitled to consideration in determining legislative intent."

3. In *Schwegmann Bros. v. Calvert Corp.*, 341 U.S. 384, 395, Mr. Justice Jackson's concurring opinion stated:

"Resort to legislative history is only justified where the face of the Act is inescapably ambiguous, and then I think we should not go beyond Committee reports, which presumably are well considered and carefully prepared. I cannot deny that I have sometimes offended against that rule. But to select casual statements from floor debates, not always distinguished for candor or accuracy, as a basis for making up our

1. The Investment Company Act is precise and leaves no room for enlargement by implication.

It is important to note the individual character of the Act. The courts have said that this particular Act is so detailed and precise as to leave no room for enlargement and amplification by speculation about supposed policy. In *Doyle v. Milton*, 73 F. Supp. 281, granting a motion to dismiss, Judge Rifkind said (pp. 284, 285):

"The Investment Company Act is a carefully framed statute in which Congress has, with particularity, stated the means and methods, both judicial and administrative, by which its declaration of policy is to be executed. It has not confided in the courts a broad discretion to shape judicially contrived remedies for the mischief it has discovered. Insofar as power is entrusted to the courts under this Act its exercise must, of course, be steered toward the fulfillment of the national policy as declared. The policy itself, however, when declared in a statute as comprehensive and detailed as this Act, does not authorize the courts to fashion sanctions withheld by Congress.

* * * * *

"* * * In the case at bar, however, the court is asked to go much further: to assume that Congress has inadvertently omitted the power to disfranchise and that the court should supply the omission. All the internal evidence points inescapably to the conclusion that the omission is deliberate. Were the courts to supply it they would engage not only in judicial lawmaking where Congress is silent but in overruling the Congressional mandate.

minds what law Congress intended to enact is to substitute ourselves for the Congress in one of its important functions. * * * It is the business of Congress to sum up its own debates in its legislation. Moreover, it is only the words of the bill that have presidential approval, where that approval is given. It is not to be supposed that, in signing a bill, the President endorses the whole Congressional Record. For us to undertake to reconstruct an enactment from legislative history is merely to involve the Court in political controversies which are quite proper in the enactment of a bill but should have no place in its interpretation."

"The motion to dismiss the second cause of action is granted."

In *Howard v. Furst*, 238 F.2d 790 (2 Cir., Nov. 13, 1956), cert. den., 353 U.S. 937, arising under the Securities Exchange Act, a companion to the Investment Company Act, the court similarly observed (p. 793):

"Ambiguous or equivocal language would hardly be sufficient to support an innovation of such far reaching effects.

* * * * *

"The Securities Exchange Act of 1934 is a comprehensive piece of legislation of wide scope. Significantly, where it was intended to create a right of action * * * the statute makes express provision therefor * * *."

As said in *Addison v. Holly Hill Co.*, 322 U.S. 607, 617, provisions in a statute "made in such detail preclude their enlargement by implication".

As it appears in the unannotated U. S. Code, the Act occupies 39½ large pages of fine print. The contrast with a statute of the constitutional brevity of the Sherman Antitrust Act (15 U.S.C. 1-7), for example, suffices to demonstrate that in the Investment Company Act of 1940 Congress chose to speak in detailed precision, leaving as little as possible to discretion and construction.

2. The Act was a compromise measure agreed on between the S.E.C. and the investment company industry.⁴

After the Commission had made its report (to which its brief here so copiously refers), it drafted the original bills which were introduced in the Senate as S. 3580 and in the House as H.R. 8935. Extensive hearings were held by the Senate Committee on Banking and Currency. The industry did not object to reasonable regu-

4. So stated in Loss, "Securities Regulation", Little, Brown and Company (1951) at page 97. The author, Mr. Loss, has been Associate General Counsel of the S.E.C.

lation, but it protested that the bill went too far, was too loose, and conferred extensive powers on the Commission to formulate standards and prohibitions. The industry argued that any restrictions should be definitively outlined by Congress, and that no discretion should be given to the Commission except to *grant exemptions* from the restrictions stated by Congress.

Toward the end of the hearings, counsel for the Commission and for the industry agreed on a set of principles for a compromise bill. These were presented to the Senate Committee, which authorized counsel for the Commission and counsel for the industry to redraft the bill. As so redrafted, the bill was introduced as S. 4108 and H.R. 10065 and was enacted by Congress substantially without change.

This history was summed up in Senate Report No. 1775, 76th Congress, 3rd Session (p. 1): -

"This bill is a substitute for S. 3580 * * *.

"Almost immediately after the conclusion of the hearings, representatives of the investment companies and of the Securities and Exchange Commission advised the chairman of the subcommittee that they believed it might be possible for them to reach a common ground and to submit a joint recommendation as to the scope and provisions of the bill. The chairman encouraged them in this endeavor, and as a result of their cooperative efforts, the substitute bill (S. 4108) was drafted.

"The substitute bill represents the result of intensive effort for a period of some five weeks by representatives of the industry and of the Commission. Not merely the principles of this bill, but also its provisions as drafted, are strongly endorsed both by the Securities and Exchange Commission and by almost every company which appeared in opposition to the bill as originally drafted."⁵

5. H.R. Report No. 2639, 76th Congress, 3rd Session, on H.R. 10065, gives the same history (p. 5):

"At the hearings before the Senate Committee on Banking and Currency * * *. At the conclusion of these hearings the investment companies who had appeared submitted to the Senate committee

As a result of the industry's insistence that the prohibitions and restrictions to be imposed upon it should be precisely stated by Congress, the compromise bill consisted of 150 pages as compared to the 95 pages of the original bill. And the industry's submission that the Commission should have discretion only to grant *exemptions* from the prohibitions of Congress is exemplified in Section 6(c) and 17(b).⁶

Mr. Alfred Jaretzki, Jr., was one of the industry representatives who drafted the Act, and in an article in 26 Wash. Univ. Law Quarterly 303 (1941) he presented what is regarded as the authoritative and leading statement of the Act's legislative history.⁷ He

specific principles for the regulation of investment trusts and investment companies. Following the submission of these counterproposals for regulation by the investment companies themselves, representatives of the Securities and Exchange Commission and of the investment companies informed the Senate Committee on Banking and Currency that it might be possible for them to reconcile their differences and to recommend a bill which would be acceptable both to the Securities and Exchange Commission and to the investment-company industry.

As a result of this cooperative effort upon the part of the Securities and Exchange Commission and the representatives of the investment-company industry, this bill, H.R. 10065, and its companion bill in the Senate, S. 4108, were recommended. They represent the result of intensive effort for a period of 5 weeks by representatives of the industry and of the Commission."

6. It is notable that throughout appellant's brief when it wishes to magnify its role as guardian of the public, what it points to in this statute are the provisions authorizing it to grant such exemptions. See, for example, Br. 67, 75, 78.

7. For example, it is said in "Federal Regulation of Investment Companies Since 1940", 63 Harv. L. Rev. 1134, at 1140 (1950), that—

"The 1940 Act was extensively discussed prior to and immediately after its enactment. Jaretzki, *The Investment Company Act of 1940*, 26 Wash. U.L.Q. 303 (1941) is probably the most authoritative treatment."

While Mr. Jaretzki is one of the counsel of record for appellees here, his article was written long before this controversy and shortly after the Act was passed.

Mr. Jaretzki's part in the drafting of the Act was stated on the floor of the House, 86 Cong. Rec. 14918; and Hearings of the Subcommittee of the Committee on Interstate and Foreign Commerce, 76th Congress, 3d Session, on H.R. 10065, at p. 63.

there summed up the matter thus (p. 311):

"In the bill as originally introduced a very large measure of discretion was vested in the Securities and Exchange Commission to formulate standards, to impose restrictions, and to regulate conduct. Under the Act as passed there was vested great discretion in the Commission, but in the main the standards and maximum prohibitions are definitely prescribed and the discretion vested in the Commission is to grant exceptions either by rules and regulations to cover general types of situations or by order in specific cases."

And again (p. 346):

"It would have been comparatively easy to draft a short act containing on the one hand very drastic and sweeping prohibitions and, on the other hand, setting up standards of practice in very general terms to be worked out case by case either by the Commission or the courts. * * * But the industry would have opposed this vigorously * * *. It therefore became necessary to formulate rather elaborate and perhaps complicated provisions to curtail, if not eliminate, the possibility of abuses which might arise from improper use of these relationships. * * *"

3. The answer of Congress to the problem of assignment of service contracts was to terminate the contract.

On the basis of its own reports on investment companies, rendered before any bill had been introduced in Congress⁸ (App. Br.,

8. In his 1941 article Mr. Jaretzki commented about these reports (p. 304):

"[These reports] must nevertheless in some measure be regarded as in the nature of *ex parte* documents which have not been subjected to the test of controversy. Many statements appearing in these reports were disputed by representatives of the industry at the Senate Hearings and much of the material is subject to misinterpretation by the uninitiated. In general, it might perhaps be fair to compare the flavor of these reports to the flavor of the bill as originally introduced and the tone of the Senate and House Reports to the tone of the bill as finally enacted." (Italics in original.)

pp. 28 et seq.), appellant argues that there was a problem in connection with the transfer of service contracts. This is true. But the problem was that transfers could result in the investors having nothing to say about the identity of the underwriter or adviser. *This* was the problem. As appellant's brief notes (p. 36), prior to the Act investors could have control over "their funds transferred to successors they did not choose or even know". And Congress met this problem by prescribing that a service contract **was not assignable at all**, and that any attempt to assign it automatically terminated it, as did transfer of control of the service corporation (see p. 28, *supra*). In short, its remedy was to require a new contract to be placed before the investors for adoption or rejection.⁹

This was Congress' answer, given after hearing the S.E.C.'s report, listening to the representatives of the industry, and then accepting the compromise bill which the S.E.C. and the industry worked out. It did not adopt any regulation other than that contained in Section 15 itself.

4. The change in Section 1 (b) and the formal reports of the Senate and House Committees.

A reading of the references made by appellant to its own pre-legislation reports will disclose that they lend its theory no support. And if we turn to legitimate legislative history, we find that *it* discloses that Congress intended to provide no remedy other than the one it explicitly stated. Section 1(b)(6) of the Act declares that the "national public interest and the interest of investors" which the Act is designed to protect are adversely affected

"when investment companies are reorganized, become inactive, or change the character of their business, *or when*

9. To the same end of preventing control or management of investment companies from being free of the control of the security holders, Section 16 restricts the proportion of directors who may be elected without their vote.

the control or management thereof is transferred, without the consent of their security holders;"

In the original bill introduced in the Senate by Senator Wagner on March 14, 1940 (S. 3580, 76th Congress, 3d Session) the comparable provision, Section 2(6), read as follows:

"when investment companies are reorganized, dissolved, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders and without adequate public supervision;"

The only change in the section as passed (besides the numbering and omission of "dissolved") is the deletion of the words "and without adequate public supervision", a clear proof that Congress deliberately decided that the only requirement it wished to impose in case of transfer of a service contract was that the investors have the right to determine for themselves whether the contract should continue. It intended no other public regulation or supervision.

It is interesting to note that in appellant's extensive quotation (pp. 32-34) from the "SEC Report on Investment Trusts and Investment Companies", it omits the following sentence which immediately preceded what it does quote:

"Throughout these entire processes of acquisition and reorganization and their attendant readjustment of shareholders' rights, no independent body existed with authority to supervise, regulate, or pass upon the fairness of changes in control, exchange offers, mergers, consolidations, and sales of the entire assets of investment companies." (p. 1029).

Section 2(6) of the original bill, drafted by the Commission itself, is in line with this passage. It may be that at one time the Commission would have liked to have a statute which gave it supervision of changes in control. But Congress granted no such authority. Congress agreed with the philosophy that knowledge by the investors and their consent were enough.

The following passage also appeared in the S.E.C. Report, after the first full paragraph quoted on page 33 of appellant's brief:

"Nevertheless, when these contracts became unprofitable or when the revenues accruing to the managers from them had substantially declined, these contracts were assigned to new interests without the *prior knowledge or consent* of the stockholders."

This sentence emphasizes the element of knowledge and consent of the stockholders.

It is noteworthy that neither of these passages appears in appellant's brief, although both were quoted in its brief in the District Court.

It is further to be noted that neither the report of the Senate Committee on Banking and Currency on S. 4108 (Report No. 1775) nor the report of the House Committee on Interstate and Foreign Commerce on H.R. 10065 (Report No. 2639) comments on any problem in connection with assignment of contracts except the lack of prior knowledge or consent of investors. Thus Senate Report No. 1775 stated (p. 7):

"Similarly, after investors have invested in companies on their faith in the reputation and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who were subsequently guilty of gross mismanagement of the companies."

This is the whole of the comment. The same is true of House Report 2639, where it was said (p. 9):

"Similarly after investors have invested in investment companies on their faith in the reputation and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who have looted the assets of such companies or to other investment companies which have subjected the stockholders to grossly unfair plans of merger, consolidation, or other corporate readjustments."

Nowhere in these official and formal Congressional reports is there a breath of suggestion that sale of stock in service corporations was to be regulated or the price limited.

5. When Congress meant to provide a specific regulation or a specific prohibition in the Act, it did so explicitly.

We have said that when Congress meant to provide a specific regulation in this particular Act, it demonstrated that it knew how to do so explicitly. Appellant's brief confirms that statement by noting many instances of detailed regulations (e.g., pp. 37, 38). For example, it points to Section 25 in support of an argument (Br. 74, et seq.) that it is not enough that the investors have the power to decide for themselves whether to reinstate a service contract after termination by assignment, and that the Commission is the guardian of the investors empowered to seek an injunction against the service corporation's acting under the new contract approved by the investors. Section 25 relates to reorganizations, and appellant argues that although reorganization plans are often voted on by the stockholders,

"Nevertheless, whether or not the plan is approved by the security holders, the Commission, under Section 25 (c), may obtain an injunction against the consummation of the plan if the court determines the plan to be 'grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors, or investment advisers of such registered company or other sponsors of such plan.' " (Br. 75)

But this argument unhorses appellant. The original bill drafted by the Commission provided that all plans of reorganization of investment companies had to be approved by the Securities and Exchange Commission. Upon objection by representatives of the industry, Section 25 was revised to its present form, and the Commission was not authorized even to comment upon plans of reorganization, except upon request by 25% of outstanding security holders, and was only given authority to institute proceedings in an appropriate District Court of the United States to enjoin a re-

organization in the circumstances mentioned by appellant. Even this limited authority is given *explicitly* and is not left to implication. This is quite reminiscent of the action of Congress in respect of Section 1 (b) (6), in striking out the recitation that it was against the national public interest and the interest of investors when the control or management of investment companies was transferred "*without adequate public supervision*". As respects assignment of a service contract Congress was content to say that the contract comes to an end, and that it is up to the investors to decide for themselves whether to recreate it.¹⁰

C. The essence of appellant's arguments is that it is not satisfied with the answer of Congress.

The gist of the present case is that appellant is not satisfied with the answer Congress gave. It lacks the faith that Congress had in the investor and is not content, as Congress was, to leave to him the question of reinstatement of a contract in any event that terminated it. Thus appellant states (Br. 70):

"There is no basis for assuming that the Congress intended Section 15 to preempt this vital and sensitive area of regulation to the exclusion of Section 36."¹¹

10. Appellant makes another self-defeating argument of the same nature, at page 75. It states:

"Similarly, certain transactions between a registered company and its affiliate are prohibited under Section 17 (a) unless an *exemption* is obtained under Section 17 (b). The grant of the exemption is conditioned on a finding by the Commission, *inter alia*, that the proposed transaction is fair and 'consistent with the general purposes' of the Act. The Commission rejected a construction which 'would, in effect, make a vote of security holders a substitute for review under Section 17 (b).'

Note that the prohibition is explicitly stated by Congress, and that the Commission was given no power but to grant an exemption (see p. 36, *supra*).

11. In its brief below appellant had said (p. 27):

"We do not doubt, of course, the importance of investor self-help and provisions to that effect, in appropriate cases, are contained in Sections 15 and 16 of the Act."

It omits this gracious admission from its brief on appeal.

This comment puts the matter backwards. The question is whether there is any basis for assuming that Congress intended something which it did not express. Unexpressed intentions are not legislation. As the Supreme Court said in *Addison v. Holly Hill Co.*, 322 U.S. 607, 617, "after all Congress expresses its meaning by words." The correct question is whether there is any basis in the statute for assuming that Congress intended Section 36 to operate on the problem explicitly dealt with in Section 15.

Appellant argues (Br. 75, 76):

"That the Congress did not declare in *haec verba* the sale of the succession to the office of investment adviser or principal underwriter to constitute a breach of trust, is not significant." ¹² (Italics in original.)

On the contrary, Congress showed, in the many detailed pages of the Act, an ability to state exactly what it wished to provide. If a further remedy was so obvious, Congress could have provided it. It did not do so. As said in *62 Cases of Jam v. United States*, 340 U.S. 593, 600,

"In our anxiety to effectuate the congressional purpose of protecting the public, we must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop."

In *Wilder Mfg. Co. v. Corn Products Co.*, 236 U.S. 165 at 174, the court refers to—

"the familiar doctrine that 'where a statute * * * gives a new right and declares the remedy, * * * the remedy can be only that which the statute prescribes.' "

In *62 Cases of Jam v. United States*, *supra*, the Court rejected the Federal Security Administrator's construction of the Federal Food, Drug and Cosmetics Act. One section dealt with imitation foods, another empowered the Administrator to fix "standards of iden-

12. This, of course, assumes that there is an "office" or that there can be a sale of the succession to the service contract. These are false assumptions. (See pp. 29, 30, *supra*).

tity". Relying on the latter the Administrator determined that no product could be marketed as "imitation jam". Said the Court, pp. 599-600:

"It looks and tastes like jam; it is unequivocally labeled 'imitation jam.' The Government does not argue that its label in any way falls short of the requirements of § 403(c). Its distribution in interstate commerce would therefore clearly seem to be authorized by that section. We could hold it to be 'misbranded' *only if we held that a practice Congress authorized by § 403(c) Congress impliedly prohibited by § 403(g).*"

So here: In Sections 15 and 2(a)(4), Congress explicitly dealt with the sale of a controlling block of stock in a service corporation, and it recognized that the contract could be reinstated by vote of the investors. A practice recognized by these sections was not prohibited by the general words of Section 36.

In *Colgate Co. v. Labor Board*, 338 U.S. 355, 363, the Court expressed the same thought:

"The Board cannot ignore the plain provisions of a valid contract made in accordance with the letter and the spirit of the statute and reform it to conform to the Board's idea of correct policy. To sustain the Board's contention would be to permit the Board under the guise of administration to put limitations in the statute not placed there by Congress."

A statute cannot be expanded by belittling the remedy Congress has provided.

Appellant discredits and belittles the machinery provided by Congress as the investor's protection. Thus it states (Br. 80):

"The intimation by the court below (R. 149) that, given the right to elect their investment adviser and principal underwriter, investors would overcome their inertia and mobilize in protest against those who pay for the succession to these contracts, seems to us implausible and unrealistic. If the court below is sustained in its view that such transactions are proper and valid, it is not likely that the investors would undertake to oppose an entrenched management which legally or *de facto* is committed to further the

interests of the successful bidder. Indeed, with the legality of these transactions no longer subject to question, the investors' trust and confidence in the old management, established over the years, will prove a weighty, and probably the controlling factor, in favor of its nominee or successor." (*Italics in original.*)

And again (Br. 55):

"Although under Section 15 these contracts are terminated, no effective opposition to any new contracts with the successors, as we shall see (pp. 80-81, *infra*), is likely to develop among public investors; nor, significantly, within the fund management, some of whose influential or controlling members, as in this case, are likely to be parties to the sale." (*Italics in original.*)

This means no more than that the *S.E.C. has no faith in the machinery* which Congress thought sufficient—no faith in the ability of investors to care for themselves. It wishes to be their guardian. **But Congress did not so provide.**

The Supreme Court has spoken about similar efforts to expand a statute by belittling Congress' handiwork. In *Bruce's Juices v. American Can Co.*, 330 U.S. 743 it said (p. 752):

"To indicate its need that the Court establish this additional remedy unauthorized by Congress, it [appellant] seeks to discredit and belittle both of the remedies Congress has expressly authorized."

And (p. 750):

"The Act prescribes sanctions, and it does not make uncollectibility of the purchase price one of them. * * * This triple damage provision to redress private injury and the criminal proceedings to vindicate the public interest are the only sanctions provided by Congress.

"It is contended that we should act judicially to add a sanction not provided by Congress by declaring the purchase price of goods uncollectible where the vendor has violated the Act. It may be admitted as argued that such a sanction would be an effective enforcement provision. Addressed to Congress, this argument might be persuasive, but the very fact that it

would obviously be an effective sanction makes it even more significant that the Act made no provision for it; that no committee dealing with the Robinson-Patman Act proposed it; that not one word suggesting its consideration appears in the debates of Congress; no proponent of the Act pointed out in its favor that it would be self-enforcing because of this sanction; and no opponent pointed with alarm to the consequences of such a drastic sanction on the commerce of the nation."

In the case just quoted the Court noted that no further remedy had been discussed in Congress. *Here more had been discussed but was rejected* (see p. 39, *supra*).

In *Switchmen's Union v. Board*, 320 U.S. 297, 301, the Supreme Court acutely observed of a contention that a certain remedy or procedure was necessary:

"Congress for reasons of its own decided upon the method for the protection of the 'right' which it created. It selected the precise machinery and fashioned the tool which it deemed suited to that end. * * * All constitutional questions aside, it is for Congress to determine how the rights which it creates shall be enforced. *Tutun v. United States*, 270 U.S. 568, 576-577. In such a case the specification of one remedy normally excludes another. [Citations omitted]"

In the leading discussion of the Act (Jaretzki, 26 Wash. Univ. L. Q. 303 (1941), it was said (p. 346):

"It was not intended that the Act should be a complete cure of all possible evils in the investment company field. It seemed wiser to proceed cautiously and experimentally, attempting to prevent the main abuses which had been known to exist."

And as said in *Addison v. Holly Hill Co.*, 322 U.S. 607, 617:

"Legislation introducing a new system is at best empirical, and not infrequently administration reveals gaps or inadequacies of one sort or another that may call for amendatory legislation. But it is no warrant for extending a statute that

experience may disclose that it should have been made more comprehensive."

There is in fact no gap in the law. But if the appellant feels otherwise, it should address itself to Congress, not to the courts. To adopt an observation made in *Lauritzen v. Larsen*, 345 U.S. 571, 593:

"The argument is misaddressed. It would be within the proprieties if addressed to Congress."

D. There has been no "gross abuse of trust" or "gross misconduct". No principle of equity supports appellant.

Failing to conjure up from legislative history a regulation of the price at which stockholders in a service corporation may sell their stock, appellant seeks to insinuate it into Section 36 through the words "gross abuse of trust" and "gross misconduct". It asks the court to create a *new* rule of equity jurisprudence:—to announce it to be a fiduciary obligation owed investment companies by certain stockholders in service corporations not to sell a controlling block of their stock for more than physical asset value. No decided case, no principle of equity governing the conduct of fiduciaries, no understanding of business relationships and realities and of the simple principles of contract law, support this effort.

Appellant smoothly speaks of "self-dealing" (e.g., Br. 33, 37), of transactions between the investment company and their service corporations, of "faithless fiduciary" (Br. 18), and of "financial frauds" (Br. 30), although, admittedly, none of these elements is present. And it makes an extensive use of other emotive adjectives, like "trafficking" and "trading" in investment advisory and principal underwriting contracts (Br. 31, 83).¹³ Characterizations like these answer no legal problem.

13. These words appear nowhere in the Act, or in the Senate or House Committee Reports or, so far as we can ascertain, in the Commission's voluminous reports.

Since a sale of controlling stock in a service corporation terminates the contract, there can be no "trafficking" (see pp. 29, 30, *supra*).

We call attention, again, to the concessions which the facts compel appellant to make (see p. 11, *supra*) and which may be summarized thus:

The transactions in question—the sale of stock in ISI by its stockholders—were transactions with outsiders and not with the Trust Fund. Here is no case of those in control dealing with their beneficiaries. No defendant bought anything from, or sold anything to, the investment company. There was no diversion, use, waste, or appopriation of assets of the Trust Fund and no mismanagement of the Fund; and appellant is “not suggesting that the new controlling interests in ISI will abuse their fiduciary position with respect to the Trust Fund” (App. Br. 80).

1. To whom the parties were fiduciary and in what respects: The right and left sides of the Chart.

There is much emphasis by appellant that ISI was a “fiduciary” to the Trust Fund. But this does not even begin to answer *any* question in the case. As said in *Securities and Commission v. Chenery Corp.*, 318 U.S. 80, 85:

“We reject a lax view of fiduciary obligations and insist upon their scrupulous observance. * * * But to say that a man is fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?”

ISI did bear a fiduciary relationship to the Trust Fund, created by a contract authorized by the Act. In the performance of *its* duties to the Fund unquestionably ISI had to observe fiduciary standards. But this did not draw its whole existence into the fiduciary orbit. And it did not make the stockholders in ISI fiduciaries to the Fund with respect to their stock in ISI.

We refer again to the chart on page 5, *supra*. That chart may be divided into two sides, a left and a right—the ISI side

and the Trust Fund side. Relationships between one side and the other are fiduciary; relationships, *inter se*, between elements wholly on one side may be fiduciary. But transactions between someone on one side, in respect of his property, *with an outsider*, are not fiduciary to the other side at all.

If ISI had sought to sell securities *to* the Trust Fund, or to buy securities *from* the Trust Fund, then it would have been acting in the realm of its fiduciary relationships. But the Act does not leave this to implication. It explicitly prohibits purchases from and sales to an investment company by its investment advisers and by directors of an investment adviser (Act, Sections 17 (a) (1) and (2)).

If ISI had sold its typewriters, its tables, or its sales organization to third parties, it could have done so at any price because it would have been acting outside of its fiduciary relationship. And similarly, when *its* stockholders sold *their* stock, they were acting outside of any fiduciary relationship borne to the Trust Fund by reason of ISI.

2. Section 36 relates to self-dealing,—to transactions between the service corporation and the investment company: This is shown by its legislative history.

In the testimony before the House Committee on the compromise bill which became the Act, Commissioner Healey of the S.E.C. said:¹⁴

"The representatives of the investment-trust industry were of the unanimous opinion *that self-dealing—that is, transactions between officers, directors, and similar persons on the one side, and investment companies with which they were associated on the other*—presented an opportunity for gross abuse by unscrupulous persons through unloading of securities upon the companies; through unfair purchases from the companies; and from obtaining of unsecured or inadequately secured loans from those companies. The industry seems to

14. Hearings of the Sub-committee of the Committee on Interstate and Foreign Commerce, 76th Congress, 3d Session, on H.R. 10065, p. 59.

recognize that even for the most conscientious management, *transactions between these affiliated persons and the investment companies present many difficulties*. Many investment companies have voluntarily barred this type of transaction—but not all of them.

"The small investors in certain investment companies, particularly in unit investment trusts and open-end management companies, have been subjected to so-called switching operations from one investment company to another, often controlled by those who controlled the first company, to the disadvantage of the investors. Similarly investors have been often powerless to protect themselves against plans of reorganization which have been grossly unfair or which have constituted gross abuses of trust on the part of their sponsors."

The Report of the Senate Committee on the bill (Report No. 1775) contained the following (p. 6):

"Basically the problems flow from the very nature of the *assets of investment companies*. The assets of such companies invariably consist of cash and securities, assets which are completely liquid, mobile and readily negotiable. Because of these characteristics, control of such funds offers manifold opportunities for exploitation by the unscrupulous managements of some companies. *These assets* can and have been easily *misappropriated and diverted* by such types of managements, and *have been employed to foster their personal interests* rather than the interests of public security holders."

And (at p. 7):

"The representatives of the investment trust industry were of the unanimous opinion that '*self-dealing*'—that is, transactions between officers, directors, and similar persons and the investment companies with which they are associated—presented opportunities for gross abuse by unscrupulous persons, through *unloading of securities upon the companies*, *unfair purchases from the companies*, the obtaining of unsecured or inadequately secured loans *from the companies*, etc. The industry recognized that, even for the most con-

scientious managements, *transactions between these affiliated persons and the investment companies* present many difficulties. Many investment companies have voluntarily barred this type of transaction."

Almost identical statements appeared in House Report No. 2639:

"That investors in investment trusts and investment companies are subject to substantial losses at the hands of unscrupulous persons is obvious from the very nature of the assets of such companies. Their assets consist almost invariably of cash and marketable securities. They are liquid, mobile, and easily negotiable. *These assets* can be easily *misappropriated, 'looted,' or otherwise misused* for the selfish purposes of those in control of these enterprises." (pp. 7, 8).

* * * * *

"Second,¹⁵ unscrupulous individuals in control of investment companies have not hesitated to engage in *self-dealing; that is, transactions between officers, directors, and similar persons and the investment companies with which they are associated*. These individuals *have sold worthless securities at extravagant prices to their controlled companies, have purchased securities and other property from such companies at unfairly low prices, and have borrowed extensively and without repayment from such companies*. The industry recognized that even for the most conscientious managements, *transactions between these affiliated persons and the investment companies* present many difficulties. Many investment companies have voluntarily barred this type of transaction." (p. 9)

It is clear that *gross abuse* relates to transactions between those guilty of it, on the one side, and the investment company on the other. There was no such transaction here.

15. This passage immediately followed that quoted at page 40, *supra*.

3. The fact is also shown by the only decision involving Section 36.

Appellant's only citation involving Section 36 is *Aldred Investment Trust v. S.E.C.*, 151 F.2d 254.¹⁶ There the investment company was a Massachusetts common-law trust, registered with the S.E.C. as an investment company. The individuals of whom the S.E.C. complained purchased shares *in the trust fund*. (By contrast in this case, the individuals owned stock in the Service Corporation.) By virtue of their ownership of these shares, they selected themselves and their nominees as trustees, not of the service corporation, but *of the trust fund itself*. Then, as trustees of the fund itself, they used the trust's assets to buy horse race tracks so as to elect themselves directors and officers of the race tracks in order to draw fat salaries. It will be observed (1) that the persons committing the misconduct were trustees and officers of the investment company itself, and (2) that their misconduct consisted of using the assets of the trust fund to their own gain. This is what Section 36 means by "gross abuse of trust" or "gross misconduct". In the brief filed by the Commission in the Court of Appeals in the *Aldred* case, the Commission said, "In substance, the judgment was that Hanlon and his associates could not be trusted with the management of other peoples' money." (pp. 43)

Appellant cites the *Aldred* case as adopting the approach of interpreting Section 36 to effectuate the "policy and purpose of the Act." We therefore quote what the S.E.C. itself said in its brief in the Court of Appeals in that case, filed in 1945 (p. 11):

"Section 36 deals only with a 'gross abuse' of trust and *is intended to cover such substantial deviation from the obligations of trusteeship as would indicate that the officers and directors involved cannot be entrusted with the management of other people's money without substantial danger that the trust will be turned to the benefit of the manager rather than to the benefit of all classes of security holders.*"

16. *Bailey v. Proctor*, 166 F.2d 392 (1 Cir.), also cited by appellant, was an aftermath of the *Aldred* case.

Yet it has been conceded in the present case that no such conduct involving mismanagement of other people's money has occurred. (See p. 48, *supra*.)

The S.E.C.'s *Aldred* brief went on to record the view *that the standards of Section 36 are tied in to the statements in Section 1 of the Act.*¹⁷ *But none of those statements has any relation to the kind of conduct involved in the present suit.* Essentially, the prohibited conduct relates to transactions done *on behalf of the trust* but which have as their purpose the serving of individual interests of the management as opposed to the interests of the investors.

4. It is only a GROSS abuse of trust or GROSS misconduct to which Section 36 applies.

The inapplicability of Section 36 is borne out by the fact that it does not speak of "abuse of trust" or "misconduct" but of "gross abuse of trust" and "gross misconduct". All terms of the Act must be given effect. The word "gross" must not be ignored.

Before Congress passed the Act courts gave relief at the suit of injured persons for acts of misconduct and abuse of trust. Congress did not entrust to the S.E.C. the vindication of all acts of misconduct or abuse of trust in the corporate field. It entrusted

17. Thus the S.E.C.'s *Aldred* brief said (p. 11):

"The statutory declaration of purposes in the Act is a codification of the fiduciary obligations imposed upon directors and officers of investment trusts; and this standard as well as the substantially identical common law standard is to be considered in determining whether there has been such substantial deviation from that standard as to constitute a gross abuse of trust. The standard, as Judge Sweeney noted, is set forth in Section 1 of the Act. Thus Section 1(b) states in part as follows:"

Here followed quotations from Section 1(b) and subdivisions 1, 2, 3, 5, 6 and 8.

Subdivision 1 refers to conduct by investors with respect to purchase or sale of securities *between them and the investment adviser*. Subdivision 2 relates to operation of the investment company or its portfolio for the interests of the fiduciary. Appellant has disavowed that it claims any such conduct here. There is no claim of violation of Subdivisions 3, 4, 5 and 8, and, of course, Subdivision 6 sets a policy which was carried out *by the precise language of the Act in Section 15 and adhered to by defendants*.

to the S.E.C. the duty and authority to take action with respect to misconduct or abuse of trust that was gross. And in order to be gross, the conduct had to be an abuse by sturdy and well-settled standards and not merely by novel or rarified views. As said by Judge Rifkind, *Securities and Exchange Commission v. Okin*, 48 F. Supp. 928, 931, in reference to provisions of the Act, they

"are intended to govern ordinary mortals, not saints. They should not be so construed as to impose canons of conduct too lofty for human acceptance."

We submit that where defendants have *not* "mismanaged or misappropriated any of the assets of the Trust Fund", there can be no case of *gross* abuse of trust.¹⁸

- 5. The sale by a stockholder in a service corporation of his stock, regardless of amount of stock or price, is not an abuse of trust "in respect of" the investment company because it does not use any asset of the investment company and is not a dealing with it.**

The stockholders of the Service Corporation did not deal *with assets of the investment company but with their own shares in the Service Corporation*. They did not deal with the Trust Fund or the investors but with strangers.

ISI, on the one hand, and the Trust Fund through its investors, on the other, entered into a contract whereby the latter agreed to

18. We do not find in appellant's brief any attempt to account for the adjective "gross". In its brief in the District Court, it argued that "gross" was used to distinguish wilful acts from mere negligence. The distinction between negligence, which is an unintentional act, and wilful conduct, which is conduct deliberately done, is so elementary in the law (Cal. Civil Code, §1714; *Donnelly v. Southern Pacific Co.*, 18 Cal. 2d 863, 869; 118 P.2d 465, 468) that if this is the distinction Congress had in mind, it would have used the customary apt words for the purpose, instead of adopting phraseology which in ordinary parlance connotes something entirely different. The progression of culpability is (1) negligence, (2) wilful conduct, and (3) maliciously wilful conduct (Bouvier's Law Dictionary, Tit. "Wilfully"). "Gross" distinguishes the third from the second, not the second from the first. The adjective "gross" and the term "gross misconduct" connote conduct reprehensible in the extreme, something abandoned and debased. Cf. *Stanley v. Jones*, 9 So. 2d 678, 201 La. 549, where a judge accepted "kickbacks", made false statements under oath, wrote threatening letters to procure votes, etc.

pay to the former fees for services rendered. Appellant apparently believes that the only reason that a purchaser of stock in a service corporation would pay more than the bare physical asset value is that he is buying the right to control the performance of the services and thus to earn fees. This, it is assumed, is an "asset of the trust". That assumption defies simple clear thinking. Yet the whole superstructure of appellant's reasoning rests upon it.

When a controlling block of stock in a service corporation is transferred, *the service contract terminates*. The Act so provides. *The purchaser of the stock thus buys no contract nor the control of one*. The investors in the trust fund at once are free to enter into a new contract with the service corporation under new control, or to refuse to do so. Doubtless the purchaser of the stock hopes that the service corporation, having done a good job in the past, can persuade the investors that it will continue to do so in the future, so as to warrant renewal of the contract and the continued earning of service fees.¹⁹ It may be that this hope is one of the factors which leads him to pay more than the bare asset value for the stock.²⁰ But even were it the sole factor, it would be irrelevant.

It is appellant's theory that any value attached to the hope or expectation that ISI will obtain a new service contract with the

19. The buyer, however, has no assurance and he takes his chances. Illustrative of this is the fact that the last sale, whereby the defendant Leach contracted in July 1956 to sell 16,000 shares of stock, expressly provided that it would be consummated whether or not the investors in the Trust Fund reinstated the investment contract or rejected it (see p. 8, *supra*).

20. Patently there are many other factors. The notion that the value of the stock of a service corporation is fixed by its asset value is naive. For example, it attaches no value to good will, which experience shows may be very great. It takes many years to build up a trained staff to supervise and manage proficiently the securities of investment companies, to build a statistical and administrative organization, and to build a selling organization to sell the securities of such a company. Large capital sums may have been expended in building up the organization; yet these expenditures are not reflected in the asset value. Organizations such as these cannot be duplicated easily. Moreover, they contain the possibility of building up a much larger business and of expanding to other fields.

Trust Fund belongs to the Fund. Thus the complaint contains the following wholly conclusory allegation which serves to show appellant's theory (R. 9; para. 20):

"The price of \$50 per share paid, and agreed to be paid, to the sellers does not represent the real and actual value of the Insurance Securities shares. The payment of 25 times the net asset value represented no payment for any asset or assets owned by Insurance Securities. Ostensibly and necessarily, the purchase price reflected the value of the perquisites and emoluments²¹ which Insurance Securities derives from the substantial fees paid, and to be paid, by the Trust Fund to Insurance Securities under the Investment Advisory and Principal Underwriting contracts, which under the Trust Agreement and under the Act, as noted in paragraph 11, *supra*, are not assignable. The value attached to said contracts are an asset of the Trust Fund, and in law and equity is preserved for the benefit of such Trust Fund."

And similar assertions are made in appellant's brief (e.g., pp. 19, 45). But the statement that "The value attached to said contracts are [sic] an asset of the Trust Fund" is simply fanciful.

Every contract has *a separate value to each party to the contract*. If it were of value to only one party, no contract would be made. Here the two parties were the Service Corporation, on the one side, and the Trust Fund, on the other. The value to the Trust Fund is that it obtained investment, administrative, and sales service. The value to the other side, ISI, lies in the fees received. To hand *that* value to the Trust Fund is to destroy the essence of contracts, which is that the contract must have a value to each side. If there is an expectation that the contract, when ter-

21. This is rhetoric. There are no perquisites and emoluments. There are merely fees for services rendered, fixed by contract, which, if not obtained from one service company, would have to be bought from another.

Appellant spends space arguing that the issue of the value of the stock cannot be determined on affidavits (Br. 46). We did not touch on that subject anywhere in our affidavits. We proceed on the basis of the factual allegations of the complaint though not its conclusions.

minated by any act specified by law, may be renewed and fees continued, and if that expectation has a value, it is a value that pertains to the ISI side of the contract, not to the Trust Fund side.

This truth is apparent from a further consideration: Suppose the stock in ISI were sold by the shareholders at a lesser price than \$50.00 per share. The same fees would continue to be paid by the Trust Fund or by the investors. Or suppose the stock were not sold at all. The same fees would continue to be paid. Or suppose that, after the sale, the Service Contract was not reinstated but was given to someone else. The same fees would continue to be paid by the Trust Fund in the future. In short, none of these contingencies has any bearing. *The sale of the stock in ISI takes away from the Trust Fund and its investors not one penny that otherwise would be kept nor adds one penny to its expense.*

6. The sale of stock in corporate fiduciaries is commonplace.

American law and economic life are replete with *corporate* fiduciaries who perform their service for an agreed fee. No one can deny that a corporate fiduciary is entitled to make a profit from its services. To deny this would constitute failure to recognize that there are "strict trusteeships" and there are "quasi-trusteeships in which self-interest and representative interests are combined."²² The present case involves the latter. The fiduciary must perform his fiduciary duties with fidelity, but he is not to be denied his compensation.

The stock of corporate fiduciaries is freely bought and sold, and the value of the stock, like the value of stock in many corporations, is fixed in relation to expected earning power of the corporation. Yet no one has ever contended that this constitutes

22. The phraseology comes from *Mosser v. Darrow*, 341 U.S. 267, 271.

a breach of trust, or that the price must be scaled down, or paid to the beneficiaries, or that the service fees must be reduced!

In San Francisco and Oakland as well as elsewhere there are numerous banks with trust departments. The expectation of earning fees from future performance of trust services is an element entering into a calculation of the value of the bank's stock. Would anyone contend that when a bank is sold to purchasers, the portion of the consideration attributable to this factor belongs in equity to the beneficiaries for whom the trust department acts? Obviously not.

Another example of a fiduciary relationship is that of life insurance companies to the insured. Yet stock in stock insurance companies is sold at prices which include as an element of value some multiple of "imputed earnings" based on "business in force." This is nothing more than an expectation that insurance written will not lapse and that premiums will continue to be paid in the future.²³

On appellant's reasoning, stockholders in trust companies or life insurance companies, if directors, would not be permitted to realize the value of their stock but would have to use their position to bring about a reduction in rates and premiums.

23. See "Investors Analyses of the Financial Position and Operating Records of Twenty-five Life Insurance Companies", published by John C. Legg & Company; p. 1 of the 1956 issue contains the following:

*"Value of Business in Force: * * ** There is, however, a decided value to the business in force. This value depends upon the mortality experience, lapse ratio, interest assumption and methods used in setting up reserves, and does, therefore, vary considerably between companies.

"The average value of the non-participating ordinary business of a life insurance company which enjoys a favorable mortality experience, a moderate lapse ratio and reserves on a sound valuation method, may be stated at \$15 per thousand. The average value of the participating ordinary may be stated at \$2.50 per thousand and the average value of the industrial business may be stated to be 26 times the weekly debit."

7. Appellant's contention rests on the claim of a "conflict of interest", and that claim is based on arguments that are speculative, naive, and assume powers not granted appellant by Congress.

Appellant's brief is replete with general propositions of equity.²⁴ But first we must see in what respect appellant contends that the sale of stock by stockholders of ISI could constitute a disregard of fiduciary obligations to the *Trust Fund*. It lies, appellant tells us, in the fact of "actual and potential conflicts of interests" (Br. 30, 36) and in the "public policy * * * to prevent corrosion of the fiduciary responsibilities of those who have undertaken to manage money or property of others or to act on their behalf" (Br. 66).

But we must press the inquiry to see precisely wherein appellant believes the "conflict" lies or the "corrosion" is possible.

- (a) Essentially appellant is seeking to set itself up as a rate regulating agency empowered to limit the fees a service corporation may earn.

Appellant states (Br. 80):

"No thought is likely to be given by those in control to use the occasion of the sale for improving the position of investors through more advantageous investment advisory or underwriting contracts with the successors, although under Section 15 the selection of the new adviser or underwriter is within the power and authority of the public investors."

Thus appellant's case is bottomed on the assumption that ISI and its stockholder-directors are under a fiduciary duty to renegotiate the service contract with the *Trust Fund* to reduce the fees to the lowest possible figure.

During the oral argument the District Court pressed appellant's counsel to state just what it was that made a sale of stock in ISI wrongful. And counsel replied, "It is the price", the fact of a profit.²⁵

24. Thus *Union Pacific Railway Co. v. Chicago etc. Ry.*, 163 U.S. 564, 601 (Br. 67, 84) merely states that equity is flexible and may devise new remedies; it pertains to procedure and not to substantive rights.

25. "The Court: No, now what is the thing, at what point are we to come in and upon what standard do we base the decision to do something,

With this the fallacy in appellant's cause stands exposed. The essence of its theory is that stockholders of a service corporation, if they are also directors of that company, may not sell their stock at a profit or at more than physical assets value. But if sale of stock at a profit means a "profiting from their fiduciary relationship to the Trust Fund", as appellant claims (Br. 12), so does the receipt of more than nominal dividends on ISI stock, for they also represent the profit earned by ISI from the service contract. To say that a director-stockholder may draw dividends so long as he holds the stock, but when he sells or dies, he or his estate cannot sell the stock at a price giving any recognition to the company's earning power,—to say that he can enjoy the value of his interest in the corporation only by remaining a stockholder, deprives his stock of one of the basic ingredients inherent in the nature of corporate stock, the right to sell.

In short, appellant's theory denies a service corporation the right to make a profit from the performance of services. If directors owning a controlling stock interest in a service company are under a fiduciary duty to renegotiate the service fees downward when they wish to sell their stock, like reasoning would impose that duty at all other times.

And if they are under this duty, how low must the fees go before equity is satisfied? To make any sense out of appellant's

putting it colloquially, personally against the men who have made the transfers?

* * * * * *

"Mr. Levy: It is the price.

* * * * * *

"The Court: Well, what you are really saying there is that you don't like this transaction, that it is just too much. They got too much money out of this thing, and it should be redistributed in some way.

* * * * * *

"The Court: But if they sold it at no profit?

* * * * * *

"Mr. Levy: If they sold it at no profit, then it is simply—there is nothing wrong, for example, for a director or for a trustee who happens to occupy a position of office—" (Transcript of hearing 87, 88, 89).

reasoning, it must mean that a service corporation may charge fees only sufficient to give it a "reasonable" return on its investment in the necessary physical assets and, possibly, to pay "reasonable" salaries. By this reasoning, *the S.E.C. sets itself up as a sort of Interstate Commerce Commission, a rate-fixing agency, or it assumes the power to ask the Court to take on that role.*

But Congress has conferred no such general power on Commission or Court. It has left fees to be determined primarily by contract between investor and service company, providing in Section 15(a) (1) that the contract must "precisely describe[s] all compensation to be paid thereunder." It has not seen fit to go further, except in limited circumstances, which demonstrate that when Congress wanted to state powers or impose restrictions it knew how to do so explicitly.²⁶ *No power was conferred to regulate fees indirectly by attacking the price at which stock can be sold.*

The right to make money out of a contract in the amounts contracted for cannot be questioned. The Act recognizes it. It follows that the expectation of renewal of profitable contracts has a capitalized value which is an asset of the company which in turn is properly an element in valuing its stock.

- (b) Contentions that there is a danger that hazardous or doubtful policies will be pursued are imaginative in the extreme.

In developing its concept of "conflict of interest", appellant becomes disingenuous. Thus it suggests (Br. 22, 80):

"* * * the purchasers may be tempted to pursue hazardous or doubtful policies in order to recoup as quickly as possible the substantial price they paid for stock control * * *."

26. In the case of periodic payment plan certificates, Section 27(a)(1) fixes the maximum "sales load", Section 27(a)(5) empowers appellant to prescribe the maximum for other fees (except administrative), and Section 27(a)(6) confers certain powers as respects a type of company not involved in this case. Section 22(c) empowers appellant to issue general rules regarding sales load. While none of these powers has been exercised, their enumeration in the Act excludes the general claim on which the Commission proceeds in this case.

To say that the owner of stock in a service corporation may not sell at a price commensurate with its value and must sell at physical asset value, would require him, if he sold, to make a gift to the purchaser. Appellant admits that "a sale of a controlling stock interest in the corporate investment adviser or principal underwriter at net asset value, or a transfer of such control by gift without more, is proper, even though the advisory or underwriting agreement is thereby terminated under Section 15" (Br. 68). Yet, if any value in the stock in excess of net asset value belong to the Trust Fund, how can the stockholder properly give this away? Once it is admitted that the director-stockholder is free to dispose of his stock, and thus of all value it carries, he must be free to sell it for its realizable value.

If an owner cannot sell without giving away most of the value, he will hold the stock and let it pass by will or descent. The consequence would be absentee ownership of the service corporation by persons who might be entirely unqualified. As said in an article in 70 Harvard Law Review (April 1957), p. 986, entitled "The Sale of Controlling Shares" referred to at page 70, *infra*:

"That the sale of controlling blocks of shares is a daily phenomenon of our economic order is evident from a casual reading of the financial pages. The writer is not aware of economic studies which purport to show the impact upon society and upon the shareholders themselves which would be caused by a policy generally restricting such transfers—although it seems obvious that if corporate managers were denied the right to profit from the sale of control they might well cling to the fruits of control long after outliving any usefulness they might have had to their corporations and to their fellow shareholders." (p. 1018)

Appellant speculates that a greater price for stock in a service corporation means hazardous policies. This is illogical. The greater the price, the more it is to the interest of the purchaser to have the service corporation serve the trust fund diligently and with skill,

for only by successful performance of its services may the service corporation expect to have the contract continue and thus earn compensation adequate to give a fair return to the purchasers of the stock. In all its speculations, appellant ignores the facts of *this* case. Under the contract between ISI and the Trust Fund, service fees are not based on the number of transactions *in the* Fund, or on the amount, kinds, or values of securities bought, sold or held by the Fund. Thus no manipulation of the Fund can increase ISI's remuneration. There can be no temptation to gamble or embark on hazardous programs. The fees are based solely on what the investors pay in (see p. 3, *supra*). The fees can grow only by an operation so successful as to attract investors.

In the article just mentioned the author, Professor Hill, further observes (p. 1018):

"It is submitted that the legislatures and courts * * * would be more responsive to suggestions *for the elimination of real evils* than to suggestions designed to produce hypothetical benefits at unknown cost."

Professor Hill is here speaking of the sale of a controlling block of stock as respects the minority stockholders in the corporation whose stock is being sold. His remarks are doubly applicable here, as we show in section 9, *infra* (at pp. 65-71).

8. Appellant's analogy to the sale by a trustee of his office is a false one.

Many of appellant's citations and arguments relate to the attempted sale by a trustee of his office²⁷ and appellant would liken that situation to the sale of control of ISI (e.g., Br. 56 et seq.). This is patently a false analogy, because a trustee cannot sell his office at all, whereas a stockholder in a corporation may sell his stock.

Inherent in the very concept of a corporate fiduciary is the right to transfer the ownership of the fiduciary by transferring its

27. Such are *Forbes v. McDonald*, 54 Cal. 98; and *Sugden v. Crossland*, 65 Eng. Rep. 620.

stock—and receive pay for it. Stock in trust companies is frequently sold; controlling blocks are sold. No case has ever suggested that this is an abuse of trust.

To say that a sale of controlling stock in a service corporation is to be treated like the sale by a personal trustee of his office defies common intelligence, particularly in view of the following:

(a) Congress specifically recognized that corporations may act as investment advisers and the like. This is implicit in the very provision that the transfer of a controlling block of the voting securities of an assignor of a service contract should terminate the contract. (Act, Sec. 2(a) (4) and Sec. 15) And see also the definition of "investment adviser", "principal underwriter", and "person", in Section 2(a) (19), (27) and (28). Appellant recognizes this. Its brief states (p. 43):

"The contingency that the investment adviser or principal underwriter may be a corporation is likewise provided for in Section 2(a) (4). The Congress fully understood that, as disclosed in the Commission's investigation, sponsors and their allies might incorporate their professional talents and render their services to the investment company as agents or officers of the corporation to be engaged as the principal underwriter or investment adviser."

And again (Br. 97):

"* * * the Congress specifically envisioned that investment advisory and principal underwriting services might be performed by persons not only as individuals but also through a corporation."

(b) Congress knew that corporations have stockholders.

(c) Congress knew that from time to time the stockholders would be selling their stock and that they might sell a controlling block. The Act contemplated such sales, because in Section 2(a) (4) (quoted p. 12, *supra*) it stated the consequences viz., *termination of the contract*.

(d) Congress further knew what everyone else knows, that one of the principal reasons for the existence of corporations is that an investor therein may transfer his interest in a manner and to an extent he could not do in the absence of the corporate arrangement.

The analogy to the sale by a trustee of his office thus fails at its foundation. Appellant cannot deny that the stock in a corporate fiduciary can be sold, whereas a trusteeship cannot be sold at all. But it would argue that if enough stock is sold to constitute control of the corporation, its price is subject to restriction. *This is not analogy. It is legislation. And it is legislation Congress did not choose to enact.*

9. Appellant's citations are not remotely relevant:—none holds that the sale of stock in one corporation is a breach of a fiduciary relation to another company or even purports to touch on the question.

With the underlying rationale of appellant's case exposed, the irrelevance of its citations is apparent. We have already mentioned some of them (pp. 52, 59, *supra*). Others involve the situation where a member of a class who assumes to exercise or enforce a class right seeks to sell it for his own profit,²⁸ or the

28. In *Clarke v. Greenberg*, 296 N.Y. 146, 71 N.E. 2d 443 (Br. 64), a party commenced a stockholder's derivative action and then sold out to the defendant at a profit so as to permit dismissal of the case. The essence of the decision is that the plaintiff in a stockholder's suit enforces a corporate right.

In *Young v. Higbee Co.*, 324 U.S. 204 (Br. 63, 66), two stockholders objected to confirmation of a plan of reorganization in bankruptcy on grounds common to all such stockholders, and they took an appeal from confirmation. Success on appeal would benefit all. They sold the appeal to the adversaries so as to permit dismissal. The case merely held that members of a class "cannot avail themselves of the statutory privilege of litigating for the interests of a class" for their own benefit (p. 213). As said in *Young v. Potts*, 161 F.2d 597 (6 Cir.), after remand from the Supreme Court:

"Potts is not held to account for the sale of his stock—he is held to account for selling out the interests of other preferred stockholders by the transfer of rights to the appeal so as to permit the purchaser of his stock to dismiss it. Bradley and Murphy were not interested in buying stock,—they were buying-off a dissident stockholder who, by his appeal, jeopardized a plan by which their junior interests were to be awarded a substantial share in the Higbee assets." (p. 600)

equally irrelevant "corporate opportunity" situation.²⁹ Another³⁰ simply held unenforceable a contract by the board of directors of a corporation to delegate all its powers, as the board, to another corporation. How far a board may delegate its powers is a subject all its own,³¹ but it is not remotely relevant because the Investment Company Act expressly permits an investment company to contract with another corporation to perform the services involved in this case, as appellant's brief recognizes (see p. 64, *supra*).

A series of citations has to do with the rights of a corporation or its minority stockholders in the event of sales of their position by directors or management of *that* corporation, sometimes achieved by sale of stock and sometimes not. For a variety of reasons these cases are not in point. For example, they are largely "looting" cases, i.e., directors sell their positions knowing that the purchaser seeks control of the corporation in order to loot it and thereafter he does loot it.³² Or they involve misrepresentations to

29. *Irving Trust Co. v. Deutsch*, 73 F.2d 121 (2 Cir.). The principle is that directors of a solvent corporation may not take over for their own profit an opportunity available to the corporation of which they are directors. If ISI had advantageously bought securities for itself of a type the Trust Fund was set up to buy, there might be an analogy.

30. *Sherman & Ellis v. Indiana Mutual Casualty Co.*, 41 F.2d 588 (7 Cir.).

31. 2 Fletcher on Corporations, Secs. 495, 496; *Dyer Bros. Iron Works v. United Iron Works*, 182 Cal. 588, 594, 595; 189 Pac. 445.

32. In *Moulton v. Field*, 179 Fed. 673, one defendant "purchased" a management contract from the corporation's manager. Then, controlling the corporation, he caused it to buy from him an utterly worthless list of names for \$200,000. The suit was to recover from him, for the corporation, that sum which had been taken from its treasury, not the sum paid by him to the former manager.

In *Bosworth v. Allen*, 168 N.Y. 157, 61 N.E. 163, the directors transferred their directorships to purchasers "whom they knew to be irresponsible and untrustworthy" (p. 163) and who thereupon wasted the corporate assets by payments to themselves and others. The gist of the case is stated thus (p. 164): "The defendants conspired to wreck the corporation of which they were directors, and to thereby make money for themselves."

In *Gerdes v. Reynolds*, 28 N.Y.S. 2d 622, after the directors sold their stock and their offices, the purchasers wasted and purloined the assets of

the minority,³³ or other special circumstances. All these citations are but exceptions to the general rule that the holder of a controlling block of stock may sell it for the best price he can, and it is immaterial that the price is enhanced by the control position of the shares. As said in 68 Harv. Law Review 1274, 1275:

"It is generally held that a stockholder may dispose of his stock in such manner and for such price as he pleases, and it is recognized that the advantages inherent in control of a corporation may make the price paid for shares composing a controlling block greater than that paid for other shares * * *. However, the freedom of the controlling stockholder to dispose of his interest has been restricted where the sale was negligently or fraudulently made to persons who then looted the corporation. *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940); see *Gerdes v. Reynolds*, 28 N.Y.S. 2d 622 (Sup. Ct. 1941)."

the company (p. 629); e.g., they went into the corporation's safe-deposit box, abstracted and sold one million dollars of securities (p. 642). Their plan was to acquire the company with its own assets (p. 645). The court said that "it would be illegal for officers and directors to resign and elect as their successors persons who they knew intended to loot the corporation's treasury" (p. 652), and held the same to be true where the circumstances put the selling directors on reasonable notice of the purchasers' unlawful purpose.

McClure v. Law, 161 N.Y. 78, 55 N.E. 388 involved a similar situation.

In *Benson v. Braun*, 145 N.Y.S. 2d 711, 286 App. Div. 1098, the complaint was held sufficient, because, as it appears from the later opinion in the same case, 155 N.Y.S. 2d 622, where the suit was dismissed, the charge was one of sale with knowledge by the sellers of the buyer's intention to loot (p. 626).

Insuranshares Corporation v. Northern Fiscal Corp., 35 F. Supp. 22, was also a looting case, as appellant's brief acknowledges (p. 37, fn. 27, and p. 47). It was—

"* * * a suit brought by a corporation against its former officers, directors, certain of its former stockholders, and others, to recover damages incurred by the corporation as a result of the sale of its control to a group who proceeded to rob it of most of its assets. * * *" (p. 23)

The purchasers' plan—

"* * * was to strip the corporation of its valuable assets, leaving its mere shell to the remaining stockholders. The project was carried out with thoroughness and dispatch * * *." (p. 24)

And this was "a program to which [the sellers] assented." (p. 24)

33. E.g., *Porter v. Healy*, 244 Pa. 427, 91 Atl. 428.

Similarly, in *Seagrave Corp. v. Mount*, 212 F.2d 389, 395, (6 Cir.), the court agreed that "as a general proposition" "majority stockholders are at liberty to dispose of their shares at any time and for any price to which they may agree without being liable to other stockholders," and it noted "recognized exceptions to the general rule" of the types mentioned above.

To the same effect: *Tryon v. Smith*, 191 Ore. 172, 229 P.2d 251, and cases cited; *Keely v. Black*, 91 N.J. Eq. 520, 111 Atl. 22; *Benson v. Braun*, 155 N.Y.S. 2d 622, 625.³⁴ As said in *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 88:

"As the Commission concedes here, the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock."

But it would be an imposition on the Court to explore the rule and its exceptions, because they relate to the duty of those in control of a corporation to the corporation itself or to the minority stockholders therein—not to outsiders. Not one case

34. It was there said:

"* * * The general rule is that a stockholder may dispose of his stock at any time and at such price as he chooses. Recognition is given to the fact that the advantages which flow from control of a corporation may make the price paid for controlling shares greater than that paid for other shares. [citations omitted] * * * The purpose of the rules restricting transfers of controlling interests is to prevent transactions tainted with bad faith, intent to defraud or negligence on the part of those possessing control. In the absence of such elements it is desirable that control of a corporation be readily transferable 'so that persons with ideas for improving a business might be able to put their ability to work'. * * * When ownership of controlling stock changes hands, a change in the board of directors is generally expected. * * * It is true that officers and directors may normally resign from office when they please. * * * Thus it is legitimate for those selling controlling shares, in connection with the sale of their stock, to resign as directors and to use their influence to bring about resignations by a majority of the board so as to facilitate the taking over of control by the purchasers."

suggests that the majority stockholders of a corporation have some duty, in respect of their shares to outsiders with whom the corporation has a service contract.

The extraordinary nature of appellant's claim may be seen by considering the special situation on which it rests so heavily, *Perlman v. Feldmann*, 219 F.2d 173 (2 Cir. 1955). There the corporation was a manufacturer of steel, and during the steel shortage of the Korean War period the controlling interests were able to get a large premium for their stock because the buyer, a user of steel, wanted in this way to get an inside track on buying steel without paying gray market prices. The opportunity of charging gray market prices was said to belong to the corporation, and the majority stockholders had no right to sell it for their own profit.³⁵

The case has been severely criticized by commentators. In the article on Corporations in the "1955 Annual Survey of American Law" (N.Y. Univ. School of Law), by De Capriles and Prunty, it is said that "already it has elicited controversial law review comment" (p. 340),³⁶ and the authors conclude, "We agree with Judge Swan's dissent" (p. 342).³⁷

35. That the opportunity of acquiring steel in a time of short supply was the gist of the case is clearly shown by the Findings of Fact entered after remand by the District Court on July 18, 1957. Thus the court found: "49. The dominant motive * * * in seeking to purchase Feldmann's controlling stock interest * * * was to obtain a continuing source of steel supply. Feldmann knew during the negotiations that such was their motive."

36. Among such comment is a long case note in 40 Cornell Law Quarterly, 786, which expresses the view that the "reasoning of the court" leads to a

"result [which] is repugnant to present day concepts of stock transferability, and * * * should be rejected."

37. They quoted the following from that dissent (219 F.2d at 178): "My brothers' opinion does not specify precisely what fiduciary duty Feldmann is held to have violated or whether it was a duty imposed upon him as the dominant stockholder or as a director of Newport. Without such specification I think that both the legal profession and the business world will find the decision confusing and will be unable to foretell the extent of its impact upon customary practices in the sale of stock."

It is not our purpose to argue about the correctness of *Perlman v. Feldmann*, since it relates to the fiduciary relation of controlling stockholders to minority stockholders in the same corporation. The significance of our comment is this: Finding in the Act no prohibition of sales of stock in a service corporation, appellant seeks to drag it in through Section 36. To this end it asserts that by Section 36 Congress intended to confer power on the Commission and to grant jurisdiction to the Courts measured by settled principles of equity jurisprudence. And then it assumes that, by a statute enacted in 1940, Congress not only intended to adopt as that measure an extraordinary and controversial decision, under Indiana law, first emanating 15 years later *but further intended to apply it to a wholly different set of relationships*, governed by an entirely different rationale and an entirely different type of regulation specifically and explicitly enacted by Congress.

In an article in 70 Harv. Law Rev. 986 (April, 1957) entitled "The Sale of Controlling Shares", the author, Professor Hill, refers to Adolph Berle's theory that one who sells a controlling interest in a corporation sells an asset of the corporation and states that this theory has not been endorsed by any court (p. 987). The article in "1955 Annual Survey of American Law" referred to above describes this as "one of Professor Berle's less felicitous metaphors" (p. 341). Yet appellant here would extend that theory into a new dimension by asserting that sale of controlling shares in a service corporation is the sale of an asset of the Trust Fund! And appellant would carry this theory backward into the mind of Congress 17 years ago.

Where shareholders sell a controlling block of stock, the minority stockholders in *that* corporation *must accept the situation*. Their own investment thus becomes subjected, willy-nilly, to the management of the purchasers. This fact is the basis of equity's concern in the special situations noted above. *But the investors in an investment company are not compelled to accept the purchasers*

of control of a service corporation for any purpose at all, because Congress has provided that the transfer of control of the service corporation terminates the service contract. If the investors do accept the new situation, they do so voluntarily by voting to reinstate the service contract. And it may be terminated at any time on 60 days' notice by the investors or by the board of directors of the Trust Fund (Act, Sec. 15(a)(3)). This unusual protection, deemed adequate by Congress, puts the investors in a position to protect themselves and distinguishes the cases of sale of corporate control.

Again, when majority stockholders exact a premium for control of a corporation, the minority stockholder in *that* corporation finds the value of his own stock affected. But when controlling shares in the Service Corporation are sold, the value of an investor's participation in the Trust Fund is not affected at all. The Trust Fund here was an "open-end" company as defined in Sections 4 and 5 of the Act (R. 5, para. 6). An open-end company is one in which the investor may have his participation redeemed on demand at a price based on the current market value of the securities held by the investment company (Act, Sec. 5(a)(1), Sec. 2(a)(31)). As appellant concedes (Br. 4), "Since the Trust Fund is an open-end company, its Participation Agreements are subject to redemption at the option of the investor upon terms specified in the Agreement." The price at which ISI stock is sold has no bearing on the value of the investor's interest in the Trust Fund.

10. Under the facts of this case there was no transfer of control of the Trust Fund, because it has its own Board of Directors.

Appellant's argument is based on the idea of transfer of control of the Trust Fund. As we have seen, this ignores the Act, which makes such transfer impossible (see p. 29, *supra*). Moreover, the argument ignores the facts of this case. The Trust Fund has its own Board of Directors (p. 13, *supra*). Under the Act, a majority of the directors of the Fund must be unconnected with ISI (Act,

Sec. 10(b)(2)), and such is the actual fact (see R. 141, 142). The Fund has 7 directors, ISI has 9, and only 3 are common to both boards, Elwood Murphey, Donald B. Rice and Leland M. Kaiser. Five of the Fund's 7 directors are not now and never have been stockholders of ISI, viz., Howard D. Ainsworth, Elwood Murphey, Brayton Wilbur, E. R. Leach and Judge A. J. Woolsey of the Superior Court, Alameda County, California. These men are substantial investors in the Trust Fund, owning around a quarter of a million dollars of participation agreements (R. 35, 36). A sixth director of the Fund, Mr. Rice, owns but 6/10 of 1% of ISI's stock (Br. 35, 36). Accordingly, neither sellers nor purchasers of stock of ISI control the Fund. The Directors of the Fund control it, and the stockholders of ISI do not elect the directors of the Fund. Those directors are elected by the investors.

While the creation of a Board of Directors of the Fund occurred after the suit was filed, it had been proposed before. If a new service contract had not been voted by the investors, appellant would lack even an excuse to argue that the stock purchasers had acquired control of the Trust Fund. Yet it was contemplated that a board of directors for the Fund would be created simultaneously with any approval of a new contract. The last stock sold was the 16,000 shares which Leach contracted in July 1956 to sell, and the consummation of that sale could not take place until the proposed amendments to the Trust Agreement were either adopted or rejected (see p. 8, *supra*). It is the present fact that controls. As said in *Sinclair Refining Co. v. Jenkins Co.*, 289 U.S. 689, 698:

"Experience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect. We find no rule of law that sets a clasp upon its pages, and forbids us to look within."

Hereafter, any decision to terminate the service contract or to reinstate it will rest with the independent Board of Directors of the Fund and, alternatively, with the investors. The directors are elected by the investors in the Fund, and the proxy machinery for

obtaining the investors' votes is under their jurisdiction and not that of ISI.³⁸

E. ISI committed no act claimed to be wrongful.

ISI is a "person" governed by Section 36, since it is the investment adviser and principal underwriter of the Trust Fund.

But ISI has committed no act of any kind which is or could be charged as being misconduct or abuse of trust. The alleged misconduct consists of the sale of certain stock *in ISI* by certain of its stockholders at certain prices. *This is not an act of ISI.* We point out in the Statement of the Case that the original complaint nowhere even charged ISI with the *conclusion* of misconduct or abuse of trust. That charge was added by amendment to the complaint, but even the amendment added no allegation that ISI had committed any act (see pp. 11, 12, *supra*).

Appellant argues thus (Br. 95; also 24):

"Liability is also imposed upon a fiduciary who condones activities, detrimental to the trust, committed by those employed to assist the fiduciary in managing the trust estate. See *Mosser v. Darrow*, 341 U.S. 267 (1951) * * *."³⁹

38. Nor did the purchasers of ISI stock have anything to do with the machinery for obtaining proxies of the investors to vote on the proposals contained in Exhibit B to the complaint (R. 18). The complaint does not allege that they had, and Exhibit B shows (R. 35, 36) that 11 of ISI's 13 directors at the time the proxies were sought had been on the Board since before any sale of stock was made.

Moreover, not a single stockholder who either bought or sold or owned any shares had participated in the action of ISI's board in submitting the matter to the investors (R. 80). This is an uncontradicted objective fact.

39. This is preceded by another statement (Br. 95), so remote from this case that it requires but passing comment:

"It is familiar doctrine that one who, not otherwise under any fiduciary obligation, participates in the commission of a breach of trust, is liable for the consequences of the breach. See *Jackson v. Smith*, 254 U.S. 586 (1921)."

In *Jackson v. Smith*, a court receiver who had the affirmative duty to try to realize the largest possible amount from a certain asset conspired with two others that one of them should bid it in at an auction and, if he succeeded in buying it, the receiver would contribute to the cost and share in the profits. The conspirators were held equally liable with the receiver.

This sentence possesses two vices. It relates to a rule not even applicable to this case, and it overstates that rule. *Mosser v. Darrow* applied the doctrine of *respondeat superior*. A trustee who knowingly permitted his agents, in the performance of the *trustee's duties*, to profit at the expense of the trust was held liable.⁴⁰ The actions which constituted wrongdoing were his actions. But the act of a stockholder in selling *his* stock is no act of the corporation. Mosser could control his own employees in the performance of their duties for him, but ISI could exercise no control over its stockholders in respect to the sale of their stock.⁴¹

Appellant attempts a reverse disregard of corporate entity.

The usual doctrine of disregard of the corporate entity is one which permits the acts of a corporation to be deemed the acts of its stockholders and holds them liable for what it did. Appellant makes an argument (Br. 99, 100) which seeks to hold the corporation responsible for what *some* of its stockholders did individually, relying on *State ex. rel. Attorney General v. Standard Oil Co.*, 49 Ohio St. 137, 30 N.E. 279 (1890). That was a *quo warranto* proceeding against Standard Oil Company of Ohio to forfeit its franchise because of its participation in the old Standard Oil Trust. There it was alleged (p. 280, 1st col.) and admitted (p. 287, 1st col.) that "*all* of the owners and holders of its capital stock, including all the officers and directors of said defendant

40. In *Mosser v. Darrow* a court-appointed reorganization trustee engaged in buying up for the trust its own securities. His duty was to buy them at the lowest possible price. He entered into an arrangement with two employees which permitted them to buy these securities tendered to the trust, on their own account, and to resell them to the trust at a profit. Had he done so himself he clearly would have been liable.

41. In the same vein, appellant cites Section 48(a) of the Investment Company Act (Br. 95, fn. 78). That section merely makes it unlawful for a person to cause an act to be done "through or by means of any other person which it would be unlawful for such person to do." But the selling of stock was not an act of ISI, directly or indirectly. Nobody sold stock owned by ISI. The stockholders, not ISI, sold their stock. Section 48 imposes criminal sanctions, and penal acts are strictly construed.

company, signed said agreements" whereby the signatories delivered their stock to the Standard Oil Trust and received trust certificates. The purpose was to use Standard Oil Company of Ohio in a conspiracy to restrain trade, and this is the background out of which the term "trust" came to be applied to illegal combinations in restraint of trade. The trust agreement provided that the corporation should be used, and it was used, to carry on the illegal activities. The gist of the court's reasoning was this (p. 288):

"Now, * * * it will be observed that this contemplated, and could not have accomplished *without, corporate action*. * * * and this was to be accomplished by the obligation imposed on its members and stockholders, *all* of whom are parties to the agreement, to authorize and require the directors and managers to make the transfer. The property and assets of the corporation could only be transferred by a corporate act, and the agreement could not, in this respect, be carried into effect, other than by such corporate act, and clearly indicates that the purpose of the stockholders of the defendant in becoming a party to it *was to affect their property and business as a corporation*; in other words, was to act *in their corporate, and not in their individual, capacity*."⁴²

This case is not in point, for the stockholders were using the corporation as a tool, and all the stockholders were involved.

In the present case there were five other stockholders of ISI besides the defendant directors, owning 28% of its outstanding stock (R. 7, para. 15). Appellant comments that 8 of ISI's stockholders participated in sales (Br. 96, 97). But 4 of the selling stockholders were not directors and were not sued, and appellant has never charged that they were guilty of a "gross abuse of trust." Its own theory will not permit it to do so, for Section 36 does not reach stockholders who were not directors or officers and occupy

⁴². Similar in its facts and reasoning is another case cited by appellant (p. 100, fn. 80), *People v. North River Sugar Refining Co.*, 121 N.Y. 582, 24 N.E. 834 (1890), involving the Sugar Trust.

no office subject to an injunction under that section (see p. 10, *supra*, and p. 78, *infra*).

Nevertheless, appellant would add the *legal* activities of the non-directors to the sales of other stockholders and then impute the whole to the corporation as *its* act and call it illegal!

To deprive ISI of its service contract would visit a penalty on stockholders who are not even alleged to have committed any act of wrongdoing whatever, on non-director stockholders, on those who sold no stock, and on the buyers as well. Appellant seeks to justify its effort to punish those innocent even under its own theory by a curious chain of reasoning (Br. 101, 102). ISI's stockholders, it says, have no vested right in having its contract with the Trust Fund continue; the right of designating who shall be the service corporation belongs to the Trust Fund and its investors; and on a termination of the contract by a sale of a controlling stock of the service corporation, "a minority stockholder cannot complain if, as a consequence, new contracts should be made with someone other than ISI" (Br. 102). All this is true, but the investors *have* exercised their right of designation by reinstating the contract, and they have *not* chosen to make a contract with someone else! The Commission wishes to veto their choice by enjoining ISI from acting.

Finally, appellant advances a self-defeating argument. It refers to Section 9(a) (3) of the Act,⁴³ and avers (Br. 98):

43. Section 9(a) (1), (2), and (3) reads:

"Sec. 9. (a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:

"(1) any person who within ten years has been convicted of any felony or misdemeanor involving the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or

"Section 9(a)(3) thus represents a Congressional determination that the corporate fiduciary is not permitted to remain in its position of trust if it retains within its organization an affiliated person involved in any wrongful securities transactions, the underlying assumption being that the retention of such person represents a danger to the investment company and its public security holders."

But Section 9(a)(3) is a very explicit provision and not so broad as appellant describes it. It makes it unlawful for a company to act as an investment adviser or principal underwriter for an investment company, if an "affiliated person" is "ineligible" to serve the investment company because he has been *convicted* of a felony or misdemeanor or has been *enjoined* by reason of misconduct from acting in certain enumerated capacities. No defendant has ever been convicted or enjoined, the complaint has not sought to enjoin ISI under Section 9(a)(3), nor is there any basis on which it could seek to do so. That section demonstrates, once again, that when Congress wished to prohibit specific conduct it knew how to say so explicitly. When it wished to forbid a company from acting because of individuals in its employ, it said so. *But* it did not ordain in Section 36 that the acts of individuals should be deemed acts of a corporation with which they are affiliated.

employee of any investment company, bank, or insurance company;
 "(2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security; or

"(3) a company any affiliated person of which is ineligible, by reason of paragraph (1) or (2), to serve or act in the foregoing capacities."

F. The remedy provided by Congress in Section 36 demonstrates that the Section has nothing to do with sales of stock in a service corporation.

The non-liability of the Service Corporation under Section 36 for sales of stock by its stockholders, just discussed, leads to a further consideration.

1. The only remedy available under Section 36 is an injunction against those committing the gross abuse from continuing in the capacities in which they committed it.

Appellant's brief is correct when it observes (pp. 27, 87) that Section 36

"is limited to a civil remedy for an injunction",

and (p. 69)

"actions under Section 36 are specifically limited to the civil remedies there prescribed".

Section 36 is unique and unlike the other sections of the Act. It does not declare "gross abuses" or "gross misconduct" *unlawful*. It did not make an act of gross abuse a federal offense. Nor did it enact that "gross abuse" should constitute conduct for which the S.E.C. can sue and obtain any kind of civil relief thought to be appropriate. Section 36 *merely grants a limited and specific federal remedy to enjoin certain persons from acting in certain capacities in certain events*. This is plain on its face, and we refer again to the text of the section, quoted at p. 6, *supra*.

Elsewhere in the Act Congress declared certain kinds of conduct unlawful (e.g., embezzlement, Sec. 37,⁴⁴ and see Sections

44. 15 U.S.C. Sec. 80a-36, which reads:

"Whoever steals, unlawfully abstracts, unlawfully and willfully converts to his own use or to the use of another, or embezzles any of the moneys, funds, securities, credits, property, or assets of any registered investment company shall be deemed guilty of a crime, and upon conviction thereof shall be subject to the penalties provided in section 80a-48 of this title. A judgment of conviction or acquittal on the merits under the laws of any State shall be a bar to any prosecution under this section for the same act or acts."

17, 18) or prohibited certain types of conduct (e.g., Section 26). And in Section 49 it provided that any person who wilfully *violates* any provision of the Act shall upon conviction be fined and imprisoned.⁴⁵

Section 36 had its origin in Section 17(e) of the original bill introduced in Congress. That section provided:

"Any gross misconduct or gross abuse of trust in respect of a registered investment company, on the part of any person registered under section 9 as an affiliated person of or principal underwriter for such company, shall be unlawful."
(S. 3580, 76th Cong., 3rd Sess.)

As so written, violation would subject the guilty person to the penal provisions of Section 49. As we have seen (p. 34 above), and as appellant concedes (Br. 87), the Act as passed was a compromise measure agreed to by the S.E.C. and representatives of the industry. The latter objected to proposed Section 17(e), and it was therefore revised into the present Section 36. The leading article on the Act, by Mr. Alfred Jaretzki, Jr. (see p. 36, *supra*), states of Section 36:

"This provision grew out of one in the original bill which made any gross misconduct or gross abuse of trust unlawful. The industry objected to it on the ground that such an indefinite standard should not be made the basis of a federal offense." (26 Wash. U.L.Q. 303, 344)

Appellant admits that the "gross abuse" or "gross misconduct" of Section 36 cannot be the subject of penal action under Section 49, but argues that "only the criminal sanctions were narrowed and limited", and that so far as civil sanctions are concerned, "the same breadth and scope must be attributed to Section 36" as to old Section 17(e) (Br. 87, 88).

45. 15 U.S.C. Sec. 80a-48:

"Any person who wilfully violates any provision of this subchapter * * * shall upon conviction be fined not more than \$10,000 or imprisoned not more than two years, or both;"

This is incorrect. As noted, Section 49 provided that any person who wilfully *violates* any provision of the Act shall upon conviction be fined and imprisoned. Section 42(e)⁴⁶ empowered the Commission to sue in equity "to enjoin such acts or practices and to enforce compliance" in case of any *violation* of the Act. Patently Sections 42(e) and 49 are *in pari materia*. Conduct which cannot be made the subject of penal proceedings under Section 49 cannot be proceeded against civilly under Section 42(e). If Section 36 had been enacted in the form of proposed Section 17(e), a "violation" would subject the violator both to the penal provisions of Section 49 and to any appropriate relief in a civil suit by the Commission under Section 42(e). But as the Act was passed, "gross abuse" is not the subject of criminal sanctions, and it is not the subject of civil sanctions (a) unless the act of "gross abuse" is also prohibited specifically in some other section than Section 36, (b) except for the remedy which Section 36 itself states. The change from a prohibition to a specific remedy alters the role of Section 36 in the Act.

The specific remedy is an injunction against the person who commits a "gross abuse of trust" or "gross misconduct" from continuing in the capacity in which he committed it. That is all.

46. 15 U.S.C. Sec. 80a-41 (e), which reads:

"Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this subchapter and sections 72(a) and 107(f) of Title 11, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper district court of the United States * * * to enjoin such acts or practices and to enforce compliance with this subchapter and sections 72(a) and 107(f) of Title 11 or any rule, regulation, or order thereunder. * * * The Commission may transmit such evidence as may be available concerning any violation of the provisions of this subchapter and sections 72(a) and 107(f) of Title 11, or of any rule, regulation, or order thereunder, to the Attorney General, who, in his discretion, may institute the appropriate criminal proceedings under this subchapter and sections 72(a) and 107(f) of Title 11."

The House Committee Report on H.R. 10065, which became the Act, makes the following statement about Section 36:⁴⁷

"36. *Injunctions against gross abuse.* This section authorizes the Commission to bring an action in a proper court of the United States to enjoin certain affiliated persons and underwriters of investment companies from acting in those capacities, alleging that the defendant or defendants have been guilty of gross misconduct or gross abuse of trust in respect of the investment company with which he or they are associated."

2. An accounting of profits is not possible under Section 36.

The complaint prays for an accounting of the profits made by Leach, Lonergan, Carr and Haight from the sale of their stock, and appellant's brief asserts (Br. 94):

"By the same token the court whose jurisdiction is invoked under Section 36 may require that those initiating the wrongful acts should account for the benefits derived as a consequence of the breach of trust. This construction of the statute is clearly essential, if Sections 15 and 36 are to fulfill the purposes that the Congress intended * * *"

We have already noted the elementary rule that it is for Congress to determine how rights it creates shall be enforced, and when it declares the remedy, that remedy is exclusive (see *Wilder Mfg. Co. v. Corn Products Co.*, 236 U.S. 165, 174; *Switchmen's Union v. Board*, 320 U.S. 297, 301; *Bruce's Juices v. American Can Co.*, 330 U.S. 743, 750; 62 *Cases of Jam v. United States*, 340 U.S. 593, and the quotations from these cases at pages 43-46, *supra*).

The question is not merely one of *lack of power of the Commission to seek* an accounting. It is also one of *lack of jurisdiction of the court to grant it at the suit of the Commission*. The Act does not empower the Commission to seek, nor confer jurisdiction on

47. Report No. 2639, 76th Congress, 3rd Session, p. 26.

the courts to grant *at the Commission's suit*, any and all types of relief in the event of a gross abuse of trust. Section 36 merely confers jurisdiction on a federal court *at the suit of the Commission* to grant a certain type of injunctive relief against certain persons occupying certain capacities.

The only argument advanced by appellant to support the claim that it can secure an accounting is in its footnote 77 on p. 94, where it states:

"See *Aldred Investment Co. v. SEC*, 151 F.2d 254, 261 (C.A. 1, 1945), certiorari denied, 326 U.S. 795 (1946), where the court said: 'Section 36 invokes the equity power of the Federal Court and that calls into play its inherent powers where necessary to do justice and grant full relief.'"

This contention, we submit, is plainly incorrect.

The principle that where the equity jurisdiction of a court is called into play, the court has inherent power to grant full relief might be applicable *if* this were a suit brought by a private person who had suffered damage or been deprived of a property interest by acts of a defendant. But the Commission is the plaintiff here, and the Commission is not an injured party. *It is merely an agency of the government empowered by Congress to seek a certain kind of relief. It can go no farther than Congress empowered it to go.* As said in *Regents v. Carroll*, 338 U.S. 586, 597: "As an administrative body, the Commission must find its powers within the compass of the authority given it by Congress."⁴⁸

48. The Court here cited *Amer. School of Magnetic Healing v. McAnulty*, 187 U.S. 94, where it said:

"Otherwise, the individual is left to the absolutely uncontrolled and arbitrary action of a public and administrative officer, whose action is unauthorized by any law and is in violation of the rights of the individual." (p. 110)

It also cited *Helvering v. Sabine Trans. Co.*, 318 U.S. 306, where the Court said (p. 311):

"We think the regulations [of the Treasury] are in the teeth of the unambiguous mandate of the statute, are contradictory of its plain terms, and amount to an attempt to legislate."

In the *Aldred* case, for abuses of trust by one Hanlon, the owner of most of the stock of the investment company (called the Trust) who had elected himself and associates trustees, the court enjoined them from continuing as officers or trustees of the Trust and appointed a receiver. While the court overruled defendants' contention that it could not appoint a receiver, the situation was different from here.⁴⁹ By enjoining the wrongdoers from exercising their control, the court left the Trust without any officers or trustees to operate it, and a receivership was therefore necessary to protect the Trust. The reasoning is lucidly set forth in (a) the brief filed in that case in the Court of Appeals by the Commission in June 1945, and (b) a brief filed by it in November 1946 in the later case of *Bailey v. McLellan*, 159 F.2d 1014 (No. 4197, 1 Cir., Oct. Term 1946) which concerned allowance of counsel fees for services in the *Aldred* litigation.

The Commission's brief in the *Aldred* case said (p. 43):

"The Court below found that Hanlon and most of his associates had grossly abused their trust and enjoined them from continuing as officers or trustees of the Trust. In substance, the judgment was that Hanlon and his associates could not be trusted with the management of other peoples' money. However, such an injunction alone would be thoroughly ineffective so long as Hanlon retained the controlling stock of the Trust. For an injunction which permitted Hanlon to nominate another group of trustees subject to his domination and control would merely perpetuate the situation which resulted in the abuse and might be expected to result in a repetition of the suit."

In its "Memorandum of the Securities and Exchange Commission, Appellee" in *Bailey v. McLellan*, the Commission said (p. 3):

"It should be emphasized that the Commission's suit was brought pursuant to a statutory duty, and its action was

49. Defendants there did not refer to the limited scope of Section 36 but based their argument on different considerations.

directed solely to ensuring that the Trust as a whole be safeguarded against the individuals who were, as it believed and has been conclusively determined, subordinating the welfare of the Trust to their own selfish interests. The request for the appointment of a receiver was in no sense separable from the relief sought against the individual wrongdoers, but was made and granted to ensure the effectiveness of the injunction against the individual defendants. It did not rest, as might appear from appellants' brief, primarily upon the insolvency of the Trust, as such, but upon the necessity of protecting the Trust from further abuse on the part of the principal wrongdoer, Hanlon. Thus, the injunction against the individual defendants and the appointment of the receiver were in essence merely opposite sides of the same coin."

The appointment of a receiver to fill the gap caused by removal by injunction of all officers may be but an incident of the injunction authorized by Section 36. But to order defendants here to account for their "profits" would not be an incident. It would be a new and different sanction. It would be legislation. We submit there is no authority for it and no jurisdiction under "the axiom that clear statutory mandate must exist to found jurisdiction." *Carroll v. United States*, 354 U.S. 394, 399.

3. The remedy provided by Section 36 is a test of what that section was intended to reach.

Bearing in mind (1) the fact that in Section 15 Congress *explicitly* dealt with the matter of transfers of control of a service corporation (see pp. 28, 37, *supra*), plus (2) the foregoing history of Section 36, and (3) the limited remedy it prescribes, we think it is beyond reason to contend that Section 36 has any relevance at all to the sale of stock in a service corporation.

The sole remedy available under Section 36 is an injunction against continuance as an officer, director or adviser of the

investment company. But if a sale of stock in a service corporation is deemed to be a "gross abuse of trust" in respect of the investment company, note how paradoxical the remedy would be! The "gross abuse" is supposed to lie in the fact of "transfer of control". Yet the remedy would oust the person from office and thus compel that very transfer of control which is supposed to constitute the wrongdoing. To oust one who steals, embezzles or engages in self-dealing with the beneficiary's funds is an apt remedy;—the punishment fits the crime. But to force a change in management as punishment for making a change in management potential is to turn things topsy-turvy. Here Leach, Lonergan, Haight and Carr are still directors of ISI. Yet appellant wishes to force them out!

Appellant's brief avers (p. 83) that it "stands to reason that * * * Congress intended to adopt measures equal to the task and purpose". We agree. Our difference is that appellant attributes to Congress a purpose broader than the measure it adopted, and then, with procrustean perversity, tries to stretch the measure to fit the imagined purpose. But the measure which Congress chose is explicit and precise, and it simply will not countenance the idea that sales of stock in a service corporation were ever contemplated by Congress as falling under Section 36.

Moreover, in relying on Section 36 as a means of regulating sales of stock of a service company, appellant is constrained to say that a sale of such stock at more than asset value constitutes misconduct only if made by a director-stockholder, because Section 36 does not apply to a stockholder holding no office. But if Congress intended the Trust Fund to be entitled equitably to any value in the stock of a service company above its asset value, there is no reason for its drawing a distinction between a director-stockholder and any other stockholder. Plainly, appellant is assigning a function to Section 36 that Congress never envisaged.

G. The individual defendants, directors of ISI, are not subject to Section 36.

All analyses of Section 36 converge to the same conclusion that sales of stock in a service corporation do not come under it. Examination of the section shows a further reason why appellant's theory is built on quicksand.

1. Section 36 applies only to persons acting in certain capacities and in respect of an investment company.

We respectfully direct the Court's attention again to the text of Section 36, quoted on page 6, *supra*. It is plain that it relates solely:

(1) to a "person serving or acting in one or more of the following capacities" and

(2) acting in that capacity "in respect of any registered investment company". The capacities are these:

- (a) An officer of the registered investment company;
- (b) A director of the registered investment company;
- (c) A member of an advisory board of the registered investment company;
- (d) The investment adviser of the registered investment company;
- (e) A depositor of the registered investment company;
- (f) Principal underwriter of certain kinds of investment companies.

Appellant fails to confront the initial question: In which of the capacities noted in the foregoing breakdown are Leach, Lonergan, Carr and Haight to be found? *The answer is that they fall in none of them.* The "registered investment company" is the Trust Fund, *not ISI* (R. 5, para. 6). Since ISI is not the investment company, Section 36 does not apply to stockholders, officers or directors of ISI, and Leach, Lonergan, Haight and Carr were not officers or directors or members of any advisory board of the Trust

Fund. Nor were they its investment adviser. As appellant concedes (Br. 91) "ISI is, of course, the investment adviser, depositor and principal underwriter for the Trust Fund".

It follows that their sales of their stock in ISI do not fall under Section 36. The only case cited by appellant on Section 36 is *Aldred Investment Trust v. SEC*, 151 F.2d 254 (discussed at p. 52, *supra*), where the individuals charged with wrongdoing were trustees of the *trust fund itself*.

We do not mean to say that *no* act of a director of a *service corporation* can fall within Section 36. We emphasize that Section 36 relates to activities of persons in certain capacities when acting "*in respect of* [the] registered investment company." When the human beings who are the officers or directors of a service corporation act *for* it, i.e., act in their capacity as *its* agents, performing *its* work, these acts would constitute *its* acts, and if they were done in respect of its duties toward the investment company, their acts would constitute its acts "*in respect of* [a] registered investment company". This would comprise buying or selling securities for the Trust Fund or selling participations in it. But when they act in their individual capacities, selling their own stock to outsiders, their acts are not its acts and cannot fall under Section 36.

This is precisely what the District Court had reference to when it said in its opinion (R. 147):

"In my opinion, no dereliction or even misconduct of officers or directors of Service Company within the area of its own independent affairs falls within the reach of Section 36. That the Congress clearly intended to so limit the reach of Section 36, *as it clearly did in precise language*, is evidenced by the fact that Section 36, when first considered by the Congress, applied to misconduct and abuse of trust generally."

In short, as a matter of plain English, the very language of Section 36 is in accord with our presentation in Part D, pp. 47-73, *supra*. Congress did not extend Section 36 to the directors of a

service corporation, because they fall outside the evil to be reached.⁵⁰

Other conduct by directors or officers of a service corporation might be subject to condemnation under the Act, but not by virtue of Section 36. They would fall under other sections of the Act. For example, a director or officer is defined by Section 2(a) (3) (quoted at p. 92, *infra*) as an "affiliated person" of the company of whom he is an officer or director; and Section 17 prohibits an affiliated person of an investment adviser from buying from the investment company or selling to it, or borrowing from it (and see Section 9). Thus a director or officer of a service corporation cannot engage in dealings *with* the investment company. We fully agree with appellant that the Act frowns on attempts of the officers or directors of a service corporation to deal with a trust fund's property or to profit at its expense. But these prohibitions were specific. They were not left to Section 36, they do not fall under Section 36. Thus Senate Report No. 1775, from which we have quoted before, stated (p. 14):

"In the future, persons who are officers, directors, investment advisers, etc., or persons affiliated with such persons may not, as principal, knowingly sell to or purchase from any investment company any securities or other property or borrow from any such investment company. Provision is made for certain exceptions with respect to transactions involving

50. Appellant refers (Br. 92) to a remark of the District Court made during a colloquy with defendant's counsel and suggests that the court indicated—

"that if the transactions constituted gross misconduct or gross abuse of trust in respect of the Trust Fund, Section 36 would apply to appellees (R. 157-158)."

The colloquy was precisely in accord with the discussion above. While the whole of it does not appear in the printed record what does appear (R. 157-8) shows the fact. A sale by a stockholder in a service corporation cannot constitute gross abuse of trust or gross misconduct in respect of the trust fund. The language of Section 36 does not cover such persons in respect of selling their stock, because there was no need for language which would. The specific language of the section was aptly selected to achieve the purpose of the section and does not countenance the imputation to Congress of a broader purpose.

the company's own security issues and for transactions exempted by the Commission (sec. 17)."

It hardly need be added that no conduct of the kind referred to occurred in this case.

2. Appellant's assertions about "evasion" are based on pure assumptions about what Congress intended.

Appellant's answer, essentially, is its same old question-begging *assumption* about what Congress intended. It may be epitomized in appellant's own phrases and epithets:

"In our view, the policy of the Congress against trading in investment advisory or principal underwriting contracts, and the related fiduciary standards and sanctions under Section 36, cannot be evaded as a consequence of incorporation." (Br. 92; similar statement on p. 23)

"Appellees' contention in effect is that immunity from Section 36 can readily be obtained, if the investment advisory and principal underwriting functions of the Trust Fund are performed by them through a separate corporation such as ISI, and the sale of the succession is effected by a sale of stock control of ISI." (Br. 92)

"* * * the tour de force which appellees contrived here. * * *" (Br. 93)

"* * * ready means for evading the statutory policy." (Br. 95)

Since Congress recognized the right of a corporation to be an investment adviser (see p. 64, *supra*), it is not an "evasion" or a "tour de force" for a corporation to be an adviser. Appellant simply lifts itself by its own bootstraps, by *assuming* that Congress was interested in regulating the price at which directors of a service corporation sold their stock in *that* company. The mode of reasoning is backwards, for it starts on the premise of a congressional policy, which it draws from the circumambient air, and from this it deduces the prohibitions of the Act. But one must deduce the policy from the prohibitions of the Act.

Wherever individuals act *as directors* of ISI relative to the performance of ISI's duties under the Service Contract, their acts would be *its* acts, which do fall under Section 36, and there *could* not be an evasion. Whenever individuals who happen to be directors of ISI act in their capacity of shareholders in ISI in selling their own stock, their acts are *not* its acts and do not pertain to ISI's fiduciary duties, and there is no prohibition to be evaded.

3. The fact that the directors of ISI may be fiduciaries to the Trust Fund does not bring them under Section 36.

Appellant misconceives the issue. Much of its argument is predicated on the claim that the directors of ISI had a fiduciary relation to the Trust Fund.⁵¹ (E.g., p. 94) But the question is not whether they are fiduciaries, but what does Section 36 say? It does not state that it applies to *all* who can be said to be fiduciaries to an investment company. It explicitly defines the precise fiduciary capacities to which it applies.

For example, appellant argues that ISI exercised all the management functions of the Trust Fund⁵², and that the directors of ISI should therefore be regarded as falling under Section 36 (Br. 100, 101). But Congress knew that some investment companies have no directors of their own. More than once *Congress made express provision for unincorporated investment companies without boards of directors* when it thought provision appropriate. For example, subdivision (h) of Section 10 provides that certain regulations of that section affecting the directors of an investment company shall apply to the directors of the depositor or investment adviser of the investment company:

51. Such is the utmost significance that can be attached to citations like *Ripperger v. Allyn*, 25 F. Supp. 554, and *Southern Pacific Co. v. Bogert*, 250 U.S. 483.

52. This was never true, for there has always been the trustee, Pacific National Bank of San Francisco (see R. 22). Moreover, the fact ceased to have any truth at all before the consummation of the sale of stock which is said to have transferred control of ISI, because the Trust Fund acquired its own Board of Directors in September 1956 (see pp. 13, 71, *supra*).

"In the case of a registered management company which is an unincorporated company not having a board of directors * * *." ⁵³

This illustrates again that the Act was written with unusually detailed precision. If Congress had intended to apply Section 36 to directors of a service corporation it would have explicitly said so, just as it did when it wished to make Section 10 applicable. Section 36 now contains two subdivisions specifying the persons to whom it applies, viz.:

"(1) as officer, director, member of an advisory board, investment adviser, or depositor; or

"(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company."

It would have been easy to add a subdivision (3) to specify

"Or as officer, director, or member of an advisory board of the investment adviser or depositor in case the registered investment company is an unincorporated company not having a board of directors."

As said in *Addison v. Holly Hill Co.*, 322 U.S. 607, 614:

"Where Congress wanted to make exemption depend on size, as it did in two or three instances not here relevant, it did so by appropriate language. Congress referred to quantity when it desired to legislate on the basis of quantity."

4. Directors of a service corporation are not directors of the investment company.

Finally, in a sort of desperation, appellant argues (Br. 100) that the directors of ISI are to be deemed directors of the Trust Fund. This argument is an afterthought. The complaint does not allege that the director-defendants are directors of the Trust Fund. On the contrary it alleges that "the Trust Fund has no officers or

53. "Management company" means "investment company" by reason of a definition in Section 4(3).

directors of its own" (R. 6, para. 8). It further alleges that the individuals are officers and directors of ISI (R. 4, para. 2). Nor does it allege that the director-defendants perform the functions of directors of the Fund. On the contrary, it alleges (R. 6, para. 8) that "management functions are discharged by Insurance Securities as Sponsor, Investment Adviser of said Trust Fund."

Appellant rests this new contention on Section 2(a) (12) which defines a "director" as "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated, including any natural person who is a member of a board of trustees of a management [i.e., investment] company created as a common law trust." But the plain meaning of Section 2(a) (12) is that any employee of an organization who performs for that organization any of the duties that would be performed by *its* board of directors if it had a board shall be deemed a director. The section does not extend the definition of director beyond the organization by which the individual is employed.

If Section 2(a) (12) had the meaning which appellant would assign to it, it would have been unnecessary for Congress to enact subsection (h) of Section 10 (discussed, p. 90, *supra*) in order to make Section 10 applicable to directors of the adviser where the investment company is unincorporated and has *no* directors.

Section 2(a) (12) defines a director and Section 2(a) (3) defines an "affiliated person".⁵⁴ Under subdivision (D) of Section 2(a) (3), a director is an "affiliated person" of the company of which he is a director; under subdivision (E) the investment adviser is an "affiliated person" of an investment company. Under subdivision (F), in case of "an unincorporated investment com-

54. Section 2(a) (3):

"'Affiliated person' of another person means * * * (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof."

pany not having a board of directors, the depositor thereof" is an affiliated person. Thus the director of a service corporation is an affiliated person of that corporation, but by definition he is not an affiliated person of the investment company which it serves, as he would be if Section 2(a)(12) were construed to treat him as a director of the investment company. Congress was precise in its definition. The director of a service corporation serving an unincorporated investment company having no board of directors of its own is not a director of the investment company. He is a director of an affiliated person of the investment company. He is reached, for example, under Section 17, as an affiliated person of an affiliated person.

This is well illustrated by the passage from Senate Report No. 1775, quoted at p. 88, *supra*, which we repeat:

"In the future, persons who are officers, directors, investment advisers, etc., *or persons affiliated with such persons* may not, as principal, knowingly sell to or purchase from any investment company * * * (sec. 17)"

To summarize: Congress might have provided that directors of a service corporation are to be deemed directors of the investment company which it serves, if the latter has no directors of its own. But Congress did not. On the contrary, it first recognized that there may be unincorporated investment companies not having a board of directors, it provided that they may be served by an investment adviser having the duty to select the securities to be bought and sold; and, having so provided, instead of saying that the directors of a service corporation are affiliated persons of an unincorporated investment company having no board of directors—which a director would be—it provided that the service corporation is the affiliated person of such an unincorporated investment company.

In Section 36, Congress is precise in naming the persons to whom it should apply, just as it is in Section 9, referred to by appellants. As has been seen, while the Act is detailed, the various sections dovetail perfectly.

THERE HAS BEEN NO TRANSFER OF A CONTROLLING BLOCK OF STOCK IN ISI

As already noted (p. 9, *supra*), appellant does not contend that *all* sales of stock in a *service corporation* for more than its physical asset value would constitute "gross abuse". An essential ingredient of the contention is that there be a sale of a "controlling stock interest" (e.g., Br. 68).

Thus far our brief has proceeded on the assumption that there was such a sale. We now submit, further, that this is not a fact. This issue the District Court did not decide, stating (R. 146):

"The Court finds it unnecessary to decide the question whether under the complaint's allegations the sale by the four named individual defendants was a transfer of a controlling stock interest in Service Company, inasmuch as decision on the motion to dismiss will be based upon the fundamental issue as to whether the statute otherwise authorizes this cause or the remedy sought."

But if a decision below is correct on any ground supported by the record, it must be affirmed, regardless of the ground on which the lower court relied. *Helvering v. Gowran*, 302 U.S. 238, 245; *Oklahoma v. Civil Service Commission*, 330 U.S. 127, 134.

A. The facts about the sales: No person sold and no person acquired 25% of the stock.

The term, "controlling block", requires reference to Section 2(a)(9) of the Act, quoted at p. 9, *supra*. It provides that one who owns more than 25% of the voting securities shall be presumed to control a company and one who does not own more than 25% shall be presumed not to control it. These presumptions are conclusive in this case.¹

1. Section 2(a)(9) provides further that "Any such presumption may be rebutted by evidence, but except as hereinafter provided, shall continue until a determination to the contrary made by the Commission by order either on its own motion or on application by an interested party".

No such determination was ever made or sought.

The undisputed facts are that no one stockholder owned as much as 25% of ISI's stock. Each of the four defendants, Leach, Lonergan, Carr and Haight, owned 30,000 shares or 18% (R. 7, para. 14). In February 1956, each sold 8,000 shares (or 4.8% apiece of the outstanding shares), through Leland M. Kaiser, an investment banker, as did another stockholder who is not a defendant (E. Smith). One D. D. Harrington bought 10,000 shares, and three insurance companies, affiliated with each other and called the Life Group, bought 10,000 shares each (R. 56, 64, 70, 72, 75, 81, 83).

In May each of the four individual defendants, Leach, Lonergan, Carr and Haight, sold another 5,000 shares (or 3% each of the total outstanding shares). These 20,000 shares, plus 1,000 sold by another stockholder who is not a defendant, were bought by Richardson & Bass (R. 58, 64, 65, 70, 73, 75) and later split between Mr. Richardson and Mr. Bass (R. 85)². In July Leach contracted to sell another 16,000 shares (or 9.6% of the outstanding shares) which Harrington agreed to buy (see p. 8, *supra*).

As consideration for the services of Mr. Kaiser as investment banker in arranging the various sales, Kaiser & Co. obtained beneficial interests in some of the shares of stock and the absolute power to vote 17,600 shares (R. 59, 60).

Thus no one of the four defendant stockholders sold, on any occasion, anywhere near 25% of ISI's stock, and no one sold as much as 25% even in the aggregate. Conversely, in no purchase did any buyer acquire any more than a small fraction of 25% of the outstanding ISI stock. And no purchaser bought as much as 25% in the aggregate.

After consummation of the last transaction the situation was as follows:

2. In the same month, Harrington in a series of purchases from 4 other stockholders bought 11,000 shares. Since the sellers were not directors of ISI, these purchases have no relation to the alleged charge of an abuse of trust and the sellers were not joined as defendants. (R. 58)

SALES

By Leach	29,000 shares or 17.4% of those outstanding
By Lonergan	13,000 shares or 7.8% of those outstanding
By Carr	13,000 shares or 7.8% of those outstanding
By Haight	13,000 shares or 7.8% of those outstanding

ACQUISITIONS

Life Group	had become the absolute owner of and entitled to vote	24,000 shares or 14.5% of those outstanding
S. W. Richardson	had become the absolute owner of and entitled to vote	8,800 shares or 5.3% of those outstanding
Perry R. Bass	had become the absolute owner of and entitled to vote	8,000 shares or 4.8% of those outstanding
D. D. Harrington	had become the absolute owner of and entitled to vote	29,600 ³ shares or 17.8% of those outstanding
Kaiser & Co.	beneficial interest and right to vote	17,600 shares or 10.6% of those outstanding

B. The situation must be examined from both the sellers' side and the buyers' side.

The question of "controlling block" must be looked at from both the sellers' side and the buyers' side. Did any seller own and sell more than 25% of ISI stock? Did any buyer buy more than 25%?

Plainly both elements must exist. Under appellant's theory, the alleged "gross misconduct" or "gross abuse of trust" is that of the person who sells, not of him who buys. If, by a series of purchases of stock from concededly separate sellers each of whom owned only 1%, a buyer should finally aggregate control, the last purchase of one share could not convert into wrongdoers all the previous sellers who theretofore were innocent and make a wrongdoer of the seller of the last share as well. Consequently, there must be a sale of a controlling block by someone who owns it.

But, conversely, if one who owns a controlling block sells it piecemeal in blocks of 1% to a series of buyers, no one has bought control, the seller has not sold a controlling block to anyone, and

3. Of which more than 1/3 was bought from non-defendants.

thus the basic predicate of appellant's theory would be lacking (see App. Br. 68, 69).⁴

C. Allegation of the complaint.

It is obvious, from the facts stated above, that no seller either owned or sold, and no buyer bought, a controlling block, unless all sellers are treated as a unit and all buyers as a unit. The only allegation in the complaint possibly bearing on that subject is this (R. 8, para. 16):

"Upon information and belief, on or about February 1, 1956, the director-defendants, either alone or in concert with others, embarked upon a plan to sell their stock interests to a small number of purchasers, affiliated among each other through stock ownership or otherwise."

This allegation, and the facts underlying it, must be examined both from the buyers' side and the sellers' side.

D. The situation from the sellers' side.

The allegation is that Leach, Lonergan, Carr and Haight "either alone or in concert *with others* embarked upon a plan". In the first place, this is not an allegation that they acted in concert *with each other*.

Second, in their affidavits these defendants denied that they acted in concert or embarked on any plan (R. 63, 69, 72, 74). It has long been held in this Court that affidavits may show an allegation to be sham, and that if the affidavits are uncontradicted, the pleading stands pierced. *Koepke v. Fontecchio*, 177 F.2d 125 (9 Cir.); *Gifford v. Travelers Protective Assn.*, 153 F.2d 209 (9 Cir.); *Lindsey v. Leavy*, 149 F.2d 899 (9 Cir.). Appellant sub-

4. Whether, in any of these circumstances, there would be a sale of a controlling block so as to terminate the service contract and require a new contract may or may not be another question, which is not relevant here. But the statement above is patently correct so far as the theory of "gross abuse of trust" under Section 36 is concerned.

mitted no affidavits or showing tending to the contrary, but merely argues that a judgment cannot be based on the affidavits of a *moving party*, though uncontradicted, if the relevant facts are within his *sole* knowledge. We think this is unsound law and not in accord with the decisions of this Circuit.⁵ But, were it assumed to be sound law, that is by no means the end of the matter, and for two separate reasons.

First: The allegation of a plan has no significance. Appellant argues (Br. 89) that "if Section 36 applies when one person transfers control by a sale of more than 25% of the stock, it is equally applicable when control is transferred by a group of persons in the same aggregate amount pursuant to a plan." Thus, having first stretched Section 36 to regulate a sale of a controlling block of stock by a single director-stockholder, appellant would extend it again to say that sales by several, none of whom owns a controlling block, are to be treated as sale by one. No authority is

5. In *Kam Koon Wan v. E. E. Black, Ltd.*, 188 F.2d 558 (9 Cir.) this Court affirmed a summary judgment on the basis of uncontradicted affidavits showing movant's good faith.

Appellant cites in support of its assertion *Toebelman v. Missouri-Kansas Pipe Line Co.*, 130 F.2d 1016 (3 Cir.) and Judge Frank's opinion in *Subin v. Goldsmith*, 224 F.2d 753 (2 Cir.). *Subin v. Goldsmith* relates merely to a situation where the material fact is the state of mind of a party. The decision may be sound where that party has the burden of proof on the issue, for the opponent is entitled to cross-examine to test credibility. If the party is disbelieved, his case will fail for want of proof. But this reasoning does not apply where affiant does not have the burden of proof. One who has the burden of proof does not establish his case by cross-examining his opponent and asking the court to disbelieve him. *Walsh v. American Trust Co.*, 7 C.A. 2d 654, 660, 47 P.2d 323; *Stewart v. Silva*, 192 Cal. 405, 411; 221 Pac. 191; see *Moore on Facts*, Sec. 131, pp. 177, 178 on "Effect of Disbelieving a Witness"; *Dyer v. MacDougall*, 201 F.2d 265 (2 Cir.). He must offer his own proof, and in opposing a motion for summary judgment must show that he has such proof to offer.

The *Toebelman* case turned on lack of adequate opportunity of the party opposing the motion to gather a showing (p. 1022, 2d col.). Moreover, the third circuit is notoriously out-of-step on the subject of summary judgments. (See note under Rule 56 in "Preliminary Draft of Proposed Amendments to Rules of Civil Procedure for the United States District Courts, prepared by the Advisory Committee on Rules for Civil Procedure", May 1954.)

cited for this claim.⁶ It challenges the definition of "controlling block" in Sec. 2(a)(9) of the Act, and the conclusiveness of the presumption created by that section.

Moreover, it defies the fact that when Congress wished to attach consequence to an action "*in concert with other persons*", it knew how to say so explicitly (Sec. 2(a)(29)).⁷

Second: Appellant's argument looks at the sales only from the *sellers' side* and does not touch on the buyers' side.

E. The situation from the buyers' side.

The fact that the stock was transferred to 7 buyers is an uncontradicted *objective* fact. It does not rest either *in state of mind* or *in the sole knowledge of any party*.

While paragraph 16 of the complaint alleges that the sellers planned to sell to buyers "affiliated * * * through stock ownership or otherwise", there is no allegation that when the sales were made, the 7 buyers were so affiliated. But let us assume that the allegation was merely inept.

Stock ownership is an *objective* fact, not involving state of mind. The affidavits concede that the three members of the Life Group are affiliated with each other. But their acquisition totals only 14 1/2%. The affidavits of *the buyers*, none of whom is a party to this cause, also establish that the other purchasers are *not*

6. The only case cited by appellant is *Pepper v. Litton*, 308 U.S. 295, 311. The Supreme Court said of it, in *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 89:

"The only question in *Pepper v. Litton*, 308 U.S. 295, was whether claims obtained by the controlling stockholders of a bankrupt corporation were to be treated equally with the claims of other creditors where the evidence revealed a scheme to defraud creditors reminiscent of some of the evils with which 13 Eliz. c. 5 was designed to cope."

7. Sec. 2(a)(29) provides:

"'Promoter' of a company or a proposed company means a person who, *acting alone or in concert with other persons*, is initiating or directing," etc.

affiliated by stock ownership.⁸ There is no contradictory affidavit. Thus the *objective* facts, *uncontradicted*, not resting on the affidavit of any party to the cause, pierce *as sham* any allegation that the buyers were affiliated by stock ownership so as to constitute single ownership of a controlling block.

As for an allegation that the buyers were "affiliated otherwise", this is a meaningless expression. Sections 2(a) (2) and (3) of the Act define the term "affiliated".⁹ So defined, it requires ownership of voting securities by one in the other, or by a common parent, or else occupation of an office by one in, or employment by, or a partnership with, the other. The affidavits of non-parties establish, without contradiction, that in no sense given by the Act were any of these buyers affiliated with others (other than the Life Group *inter se*).

Appellant nowhere states what it means by "affiliated otherwise" or how it conceives that an "affiliation otherwise" would be significant. Was it intended to mean merely that the buyers have an agreement with each other to act as a unit? If so, each buyer has filed an affidavit that he entered into no such agreement (R. 82, 84, 86, 87). There is no contradicting affidavit and no docu-

8. Affidavit of Harrington, R. 81; of John D. Murchison, R. 83; of Richardson, R. 85; of Bass, R. 87.

9. They provide:

"(2) 'Affiliated company' means a company which is an affiliated person.

"(3) 'Affiliated person' of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof."

ment from which any contrary inference can be drawn. The affiant-buyers are not defendants, and the alleged rule about state of mind of an adverse party does not apply.

F. The irrelevance of the affidavits filed by appellant.

Mr. Kaiser is an investment banker, and it has been part of his profession to find buyers for securities seeking buyers and opportunities for capital seeking investment. His attention was first drawn to ISI largely by the fact that its president, the defendant Leach, was over 80 years old. It occurred to Mr. Kaiser that, in the due course of events, the Leach stock would be offered for sale. He therefore approached Mr. Leach, who first stated that he was not interested in selling, but on a later approach stated that he would sell none of his stock unless an opportunity were given to other stockholders to sell theirs (R. 56).¹⁰

Appellant reviews these facts and notes that the possible sale of ISI stock was first brought to the attention of the Commission's staff in September 1955 (Br. 7). About this time Mr. Leach, through his attorney, Mr. Elwood Murphey, learned of the Commission's view which it seeks to enforce in this lawsuit. As appellant notes, Mr. Murphey called on the Commission's staff to discuss the matter, and Mr. Kaiser had correspondence with the Commission on the subject and disagreed with its interpretation of Section 36 (App. Br. 7, 8).

All this is true. But it is irrelevant. The Commission's views having been learned, consultation was had with counsel.¹¹ The views of an administrative bureau do not make the law, and it is the privilege of free-born citizens to disagree.

Appellant then asserts, at various points, that the sales were cast in the form of separate, successive transactions (App. Br. 7)

10. Mr. Leach was thus faithful to a standard of ethics higher than equity requires.

11. Mr. Jaretzki's intimate knowledge of the Act and its origin have been pointed out at p. 36, *supra*.

and insinuates that this was done as a mask or a subterfuge to avoid transferring "control", calling the separate sales "stage props" (Cf. App. Br. 82). But terms like "evasion" and "stage props" are mere epithets and evince a disregard for some elementary principles of law.

While defendants disagreed with the Commission's views that a sale of a controlling block of stock in the Service Corporation would constitute "gross abuse of trust" toward the Trust Fund, nevertheless no one wishes to engage in controversy with a government bureau if it can be avoided, for to be pursued by it by fire and sword is a great burden both in expense and in other ways.¹² For example, defendants have been accused of "gross abuse of trust" with the wide-spread publicity always given charges made by government bureaus. This harmful publicity has hardly been mollified by the explanation that the term "gross

12. As a consequence, too often people succumb to the views of bureaus although convinced they are in error. Such may be the fact in the "uncontested case" of one Gardiner which appellant exhumes from its files and reviews (Br. pp. 78, 79). Appellant states that Gardiner owned 50% of the stock of Management Associates which performed services for Incorporated Investors, that he died, and his executors turned in his stock in Management Associates to that corporation itself for redemption at net asset value. What bearing this has on the present case escapes us. When Gardiner died, his executors occupied no office in either Incorporated Investors or Management Associates, and so a sale by them could not fall under Section 36 even under appellant's theory. Moreover, there is nothing to show that anyone was willing to pay more than asset value, or that there was any opportunity to sell other than by redemption. Appellant asserts that "the parties and the Commission agreed that, since the contract is nonassignable, no value may properly be attributed to it for the benefit of the selling stockholder or his estate." This is a gratuitous assertion; the Commission's releases, Nos. 1911 and 1947, to which appellant refers contain no verification of the assertion. But even if it were a fact, it would be worthless in interpreting Section 36. The releases show no more than this: If Gardiner's death constituted a transfer of the stock to his estate, the service contract ended. Exemption from the need of getting a reinstatement from the investors for a period of time was sought and obtained under Section 15(a) of the Act "because of the *possible* assignment of the investment advisory contract that resulted when [the] shares * * * were transferred by operation of law to the estate of * * * Gardiner at the date of his death * * *." (Release No. 1947.)

abuse of trust" is used by the Commission in this case in a Pickwickian sense and does not mean mismanagement, embezzlement, or waste of the assets of the Trust Fund (see pp. 7, 11, *supra*). In the hidden recesses of its brief on appeal (p. 80) appellant concedes that

"We are not suggesting that the new controlling interests in ISI will abuse their fiduciary position with respect to the Trust Funds."

But no such disclaimer ever comes to the attention of an investing public or ever catches up with the first publicity blast. The investors see only the foul words, "gross abuse of trust".

In these circumstances each individual defendant decided that he would make no sale that would enable any purchaser to acquire a controlling block. The options which each gave to Mr. Kaiser stated explicitly that he, as the investment banker, must find buyers such that no one would acquire as much as 25% (App. Br. 9).

Appellant insinuates that this was "evasion". But it is not "evasion" of the prohibitions of a law to avoid doing what the law prohibits and to do instead what it does not prohibit. As Mr. Justice Holmes frequently admonished:

"We do not speak of evasion, because, when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits." *Bullen v. Wisconsin*, 240 U.S. 625, 630.

So also: *Superior Oil Co. v. Mississippi*, 280 U.S. 390, 395 (per Holmes, J.); *United States v. Isham*, 17 Wall. (84 U.S.) 496; *Iowa Bridge Co. v. Commissioner*, 39 F.2d 777, 781 (8 Cir.); *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403.¹³

13. *In re George Inglefield, Limited* (1933) 1 Ch. 1, the Court of Appeals of England said:

"It is not a question of evasion. A transaction is either within or without the law, and malice is not to be attributed to a person who

We deny that sale of a "controlling block" of stock in ISI at any price would violate Section 36 of the Act. And the District Court so held. We further deny that a controlling block was bought or sold. And if it be a fact that the sale of a "controlling block" was avoided in order to avoid conflict with the Commission's notions of the law, that would not constitute "evasion".

We submit that the complaint did not allege the sale of a controlling block. We further submit the uncontradicted showing that there was no such sale. It was incumbent on appellant to meet this showing by *facts*, not by insinuation and epithet. It did not do so.

so carries out a transaction that it remains outside the law. (pp. 22-23)

* * * * *

"If a man so conducts his affairs that he places himself outside the operation of an Act of Parliament he cannot be said to be either evading it, or defeating it. He has done nothing that is unlawful, and he has done nothing that calls for adverse comment from the Court." (p. 26)

In *Yorkshire Railway Wagon Company v. Maclure*, 21 Ch. Div. 309 (1882), Jessel, M. R., commented:

"Thereupon, like sensible men, they consulted their solicitors, and their solicitors, like sensible men, took the opinion of eminent counsel. * * *" (p. 312)

It was further said:

"* * * It is said to be an evasion of the Act of Parliament really to borrow the money. There is always an ambiguity about the expression 'evading an Act of Parliament.' In one sense you cannot evade an Act of Parliament; that is to say, the Court is bound so to construe every Act of Parliament as to take care that that which is really prohibited may be held void. On the other hand, you may avoid doing that which is prohibited by the Act of Parliament and you may do something else equally advantageous to you, which is not prohibited by the Act of Parliament." (p. 319)

PART TWO OF THE ARGUMENT

Count Two States No Claim for Relief

Since appellant concedes that Count Two fails with Count One (see p. 15, *supra*), we could leave Count Two with our submission of Count One. However, Count Two possesses its own deficiencies, and those going to the merits illustrate the extreme nature of the Commission's contentions and help to appraise its approach to the whole case. We therefore discuss the subject briefly.

I.

COUNT TWO IS MOOT

If the proxy statement were misleading, the basic wrong was to solicit the proxies, and the primary remedy was to enjoin the solicitation. An injunction against the use of proxies, after they have been obtained, is itself an extension of the remedy which occasioned no little doubt when first asserted in *Securities and Exchange Commission v. Okin*, 58 F. Supp. 20, 21.¹

Yet here the proxies have been voted (pp. 13, 15, *supra*). When a trial court dismisses a complaint seeking an injunction, and the object sought to be enjoined is accomplished before or pending appeal, the cause is moot. *Wingert v. First National Bank*, 223 U.S. 670; *Love v. Griffith*, 266 U.S. 32; *Arkansas & Louisiana Missouri Railway Co. v. Amarillo-Borger Express, Inc.*, 352 U.S. 1028.

Apparently appellant now wishes to push the remedy farther than any court has ever gone, although it does not specify exactly what it does seek (Br. pp. 110, 111). It states (Br. 111):

1. The court there said:

"This case, however, goes a step farther than any of the cases cited above or any other case to which my attention has been called. Here it is sought to restrain, not only the making of false or misleading statements, but also to restrain the use at the annual meeting of proxies obtained by defendant as a result of sending out any statement which is held to be violative of the rules mentioned."

"The Commission's motion for a preliminary injunction was withdrawn upon the understanding, as set forth in the Second Interlocutory Order, that it was without prejudice to the power of the court to grant appropriate relief, 'including any action with respect to the Investment Advisory and Principal Underwriting Contracts, whether or not approved by Investors in the Trust Fund, if it is determined in a final decree that plaintiff is entitled to judgment' (R. 95)."

This was merely a statement that by entering the stipulation the Commission did not waive the right to seek any relief still within the power of the Court to grant; it was not a waiver by defendants of the right to contend that no relief could be granted. The stipulation neither subtracted nor added to the Court's power.

Moreover, the relief sought could only be an injunction against operation under the new service contract effected by the vote of the proxies. But this too is moot, because appellant seeks the same relief under Count One. If Count One is bad, Count Two concededly fails. If appellant is correct in its contentions with respect to Count One, Count Two is now pure superfluity.

Count Two is thus deadwood.

II.

ON THE MERITS AND APART FROM COUNT ONE, COUNT TWO STATES NO CLAIM FOR RELIEF.

A. The proxy statement and the proxy rule.

Section 20(a) of the Act provides that it shall be unlawful for any person to solicit any proxy in respect of a security issued by a registered investment company

"in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Under this section the Commission promulgated its Rule N-20A-1 which adopted its proxy rule issued under the Securities Exchange Act. That rule (17 C.F.R. 240.14a-9) reads:

"No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, *or which omits to state any material fact necessary in order to make the statements therein not false or misleading* or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

The issue is whether the proxy statement violated this proxy rule. The proxy material is Exhibit B of the complaint (R. 18-47), and the only pertinent passage is this statement (R. 33):

"Mr. Leach now proposes to retire as the chief executive of the Company and will assume the less active role of Chairman of the Board. At the same time he advises us that he is selling substantially all of the balance of the stock of the Company which he holds, amounting to 10.24% of the stock of the Company, to other stockholders of the Company. Upon the consummation of this sale, the old stockholders of the Company, being those who have held stock for over 16 years, will hold less than a majority of its shares, to be precise 45.78% thereof, and the Company is advised that *this change in majority ownership may be considered an assignment of the contract between the owners of the Trust Fund and the Company concerning matters of Investment Advising and Principal Underwriting, as defined in the Investment Act of 1940. Under the terms of such contract and such Act, a termination of the contract takes place upon its assignment.*"

The proxy rule, it will be seen, prescribes that a proxy statement may be misleading and false in two respects:²

2. Appellant's brief (p. 104) correctly notes a third respect, omission to state a fact necessary to correct a false statement in an earlier communication. But there were no earlier communications involved in this case, and appellant mentions none.

1. In affirmatively stating a material fact that is false or misleading; and

2. In omitting "to state any material fact necessary in order to make the statements therein not false or misleading."

The complaint seems to claim one affirmative statement of a false or misleading fact and three items of omission.

B. The alleged misstatement is no misstatement at all.

Paragraph 28 of the complaint alleges (R. 12):

"In the proxy statement it is alleged that the 'company is advised' that the 'change in majority ownership' of Insurance Securities stock 'may be considered an assignment' of said contracts by the terms of the contracts and under the Act. The Commission alleges that under the facts and circumstances here presented such contracts have been terminated."

The passage quoted above from the proxy statement said that the events "may be considered an assignment" and that "a termination of the contract takes place upon its assignment". Apparently the contention is that the proxy statement was misleading in not stating that the contract *had* terminated!

Here is a situation where the company soliciting the proxy has in effect said to the investors: "We seek a reinstatement of the contract, and we are putting it to your vote for the simple reason that it may have terminated." This is no different in any relevant sense from a statement that "We seek reinstatement of a contract because it has terminated." In either event the action taken by the solicitor of the proxies and the action sought of those solicited proceeds *as if* the contract had terminated. The solicitation states, in effect, that reinstatement is sought because for the sake of caution ISI does not want to proceed on the basis that the contract is still in effect. The investors' vote would not have been influenced by stating the matter one way instead of the other.³

3. In *Phillips v. The United Corporation*, Federal Securities Law Reporter, '45-'47 Dec. para. 90,395, the court said, p. 91,072:

"In *S.E.C. v. Okin*, 58 F. Supp. 20 (S.D. N.Y. 1944) the Court noted that the statement or omission claimed to be misleading must be such as would have influenced the stockholder's vote."

Appellant's claim as expressed in the complaint is that the proxy statement was misleading in not adopting its position in this suit on the issue of whether a "controlling block" of stock was sold. But appellant's brief does not discuss the charge made in paragraph 28 of the complaint. Instead it asserts (Br. 105):

"Also, the ISI proxy letter sent to investors in the Trust Fund stated that the change in control of ISI may have 'the technical effect' of terminating ISI's investment advisory and principal underwriting contracts with the Trust Fund. * * * it was false and misleading to characterize such effect as merely 'technical'."

This refers to the following passage in the covering letter by which the proxy statement was sent to the investors (R. 21):

"In connection with Mr. Leach's semi-retirement, he is selling substantially all of his stock of the Company to other stockholders. As explained in the Proxy Statement, this sale, together with other sales of stock made in the past, may have the technical effect of terminating the Investment Advisory and Underwriting Contracts of the Company under the Trust Agreement. Therefore, these contracts are submitted to the investors for reinstatement."

But neither in the original complaint nor in the amended complaint did Count Two charge that the use of the word "technical" was misleading. Appellant thus abandons the accusation of the complaint and seeks to substitute another by its brief. Moreover, appellant's quotation of the passage from the proxy letter where the word "technical" is used is itself a misleading half-quote. The statement was preceded in the proxy letter by the words, "As explained in the Proxy Statement * * *" (R. 21). The latter went into the matter in detail and did not contain the word "technical".

But apart from all this, to assume that the use of the word "technical" was misleading is not only an afterthought but frivolous.

Leach, Lonergan, Haight and Carr sold 68,000 shares or 40.8% of all outstanding. If taken in the aggregate, this was "control" within the meaning of the Act because it is more than 25%. But these four individuals continue to own 52,000 shares, or 31-1/3%, which is also "control" within the meaning of the Act. Thus, even if they transferred control, they still have it, and having "transferred" it once, they could "transfer" it again! In the circumstances the adjective "technical" is wholly apt. In any event its use was not misleading.

C. The "alleged omissions boil down to nothing at all".

The other alleged violations of the proxy rule are all omissions. As appellant sums up its contention (Br. 104, 105): "the proxy material * * * was false and misleading in that it failed to disclose material facts." But in the language of *Subin v. Goldsmith*, 224 F.2d 753, 775 (2 Cir.), the "alleged omissions * * * boil down to nothing at all."

Paragraph 30 of the complaint (R. 12) claims that the proxy statement should have added that "the company has also been advised by the staff of the Commission that, on the facts presented, the change in majority ownership may also involve gross misconduct and gross abuse of trust under Section 36 of the Act."

Paragraph 31 (R. 13) claims that the proxy statement should have stated the price at which the defendants Leach, Lonergan, Carr and Haight had sold their stock in ISI.

The last item of alleged omission is an afterthought upon an afterthought, not in the original complaint, but added to paragraph 31 by amendment (R. 47). As amended, that paragraph charges that the proxy statement was misleading in not stating the "net book value" per share of ISI stock and the profit which the director-defendants made or would make on the sale of their stock.

Appellant does not contend (Br. 109) that there was any "outright falsehood", or "ambiguous statement deliberately contrived",

in other words, any half truth, or that any of the omitted items was "related to some affirmative statement or representation already contained in the proxy statement". The passage in the proxy statement, quoted above, states that Leach was selling substantially all his remaining stock, amounting to 10.24% of that outstanding, to other shareholders, that upon consummation of the sale the old shareholders would hold less than a majority, and that this change in ownership might terminate the contract. The claimed omissions simply have no relation whatever to any of these statements. Admittedly, there are *no affirmative allegations in the proxy material, singly or as a whole, which became misleading because of the absence of any of the sentences which appellant contends should have been included.*

Appellant merely claims that there was a "failure to disclose material information", blandly asserting that the "purpose of the Proxy Rules is to require full disclosure of material information." (Br. 104, 108, 109).

This argument fails for two separate reasons, which we briefly consider.

1. Appellant misinterprets the proxy regulation.

The proxy rule, which is quoted above, does *not* require the proxy solicitation to contain data which the SEC thinks the recipient should know. It does *not* provide that "failure to disclose material information" is a violation. *The requirement is that the proxy statement should not omit a fact necessary to prevent affirmative statements from being misleading. This is the plain language of the rule.* English can be no plainer, simpler, less equivocal, or less requiring construction. Thus, in *Securities and Exchange Commission v. Okin*, 58 F.Supp. 20, the court said that the rule

"require[d] a statement of material facts necessary to make the assertions therein not false or misleading". (p. 21)

Since the SEC was empowered by Congress to lay down proxy rules, possibly it could have laid down a broader rule than it did.

But it did not do so. And until it has done so, it can only invoke the rule which it has adopted within its delegated power. *Tobin v. Edward S. Wagner Co.*, 187 F.2d 977 (2 Cir.).⁴

The language of SEC's proxy rule is similar to the language of Section 49 of the Act (15 U.S.C. § 80a-48) which provides:

"* * * or any person who wilfully in any * * * document * * * makes any untrue statement of a material fact or omits to state any material fact necessary in order to prevent the statements made therein from being materially misleading in the light of the circumstances under which they were made, shall upon conviction be fined * * * or imprisoned * * * or both * * *."

The language in the proxy rule and in the statute being similar, they must receive the same interpretation. *F.C.C. v. American Broadcasting Co.*, 347 U.S. 284, 296. And since the statute is penal, no latitudinarian interpretation is possible.

Appellant (Br. 109, 110) cites two cases, one dealing with an analogous but not identical regulation⁵ and the other with a common law situation.⁶ Both cases are cited in the discussion of

4. The court there said:

"* * * when the legislature delegates to an administrative official the authority, by 'sublegislation,' to issue regulations * * *, then the regulations, precisely because they particularize, ought not to be as generously interpreted as the statute. In fairness to the regulated, the provisions of the regulations should not be deemed to include what the administrator, exercising his delegated power, might have covered but did not cover" (p. 979).

5. In *Hughes v. Securities and Exchange Commission*, 174 F.2d 969. Hughes was an investment adviser. When she advised a client to buy a particular stock, she would sell it to the client from her own holdings or would buy it on the market to resell to him. While she informed the clients that she would act as "principal" in every transaction she recommended, she did not tell them the nature and extent of her adverse interest in the transaction *with them*; for example, she did not tell them that they could purchase the stock more cheaply if they bought it in the open market rather than from her. The case is thus also a case of sales and dealings *between fiduciary and beneficiary*, while the present case is not.

6. *Equitable Life Ins. Co. v. Halsey, Stuart & Co.*, 312 U.S. 410.

the subject in the leading treatise—*Loss, Securities Regulation*—which concludes:

"But those provisions are still limited to *half-truths*⁷ as distinct from complete omissions to disclose anything. They do not require the seller 'to state every fact about a stock offered that a prospective purchaser might like to know or that might, if known, tend to influence his decision.' " (p. 819)

Loss cites *Otis & Co. v. Securities and Exchange Commission*, 106 F.2d 579, (6 Cir.) where the court states of analogous regulations (p. 582):

"The statute did not require appellant to state every fact about stock offered that a prospective purchaser might like to know or that might, if known, tend to influence his decision, but it did require appellant not 'to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.' "

S.E.C. Regulation X-14 (17 C.F.R. 240.14) requires *certain* data to be *affirmatively* stated but otherwise directs itself to the prohibition of misleading statements. Apart from the affirmative data thus required, proxy material would not have to contain any statements at all. Common sense tells us why the SEC has never framed a rule requiring the affirmative inclusion of "material" facts. The number of facts which could be claimed to be material to any question would be endless. Only the breadth of human imagination could place boundaries on what might be thought to influence the decision of at least one person asked to give his proxy. Under such a requirement every proxy statement would have to be a book of pros and cons, for there is nothing easier than to excogitate, *ex post facto*, that some fact or other would have been material.

7. Appellant's quotation (at Br. 110) from the *Hughes* case itself refers to the "telling of half-truths".

Since private parties as well as the Commission can sue for violation of the proxy rules (*Textron, Inc. v. American Woolen Co.*, 122 F. Supp. 305, 308), appellant's present interpretation of the rule could open up a Pandora's box of litigation between intra-corporate factions in the proxy battles not infrequent in business today.

2. Moreover, the so-called omitted facts were not material.

The term "material" requires reference to something. Here, it is the question whether the investors wished to reinstate the service contract. The only train of reasoning by which appellant argues "materiality" is (Br. 109):

"When asked for their consent [to the reinstatement of the contract], investors are entitled to appraise whether the recommendations of the management are disinterested or moved by considerations of personal gain."⁸

But it was self-evident to the investors that reinstatement of the contract was to the interest of ISI; that is why ISI sent out the proxies.⁹ Moreover, the price paid to the selling stockholders and the profit made *by them*, from the sale, had no bearing on whether reinstatement of the contract was to ISI's advantage and no bearing on the measure of the advantage. If anything would be material to *such* matters, it would be the fees paid *to* ISI for the service rendered. This *was* stated in the proxy solicitation material (R. 29, 30, 31, 32).

8. Neither the selling stockholders nor buyers made any "recommendation" at all. ISI, the corporation, merely indicated that it favored a yes vote, but it sent out no arguments or "sales talk" in favor of approval. (R. 46)

9. The case is wholly unlike *Dunnett v. Arn*, 71 F.2d 912 (10 Cir.), cited by appellant. That case did not arise under any statute or regulation but involved a common law question. The holders of a majority of stock made a deal to sell all the stock to the buyer so that it could acquire the corporate assets, sold their own shares at a certain price and falsely implied to the other stockholders that they had sold for less in order to induce the latter to do likewise.

CONCLUSION

Paraphrasing *Helvering v. Sabine Trans. Co.*, 318 U.S. 306, 311, the contentions of the Commission "are in the teeth of the unambiguous mandate of the statute, are contradictory of its plain terms, and amount to an attempt to legislate."

We respectfully submit that this Court should lend it no hand, and that the judgment of dismissal should be affirmed.

Dated: San Francisco, September 12, 1957.

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 15457

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

**INSURANCE SECURITIES INCORPORATED, TRUST FUND
SPONSORED BY INSURANCE SECURITIES INCORPORATED,
ABE P. LEACH, OSSIAN E. CARR, ARTHUR J. LONER-
GAN, ROY A. HAIGHT, AND LELAND M. KAISER AS
ATTORNEY AND PROXY FOR INVESTORS OF TRUST FUND,
APPELLEES**

**REPLY BRIEF OF SECURITIES AND EXCHANGE COMMISSION,
APPELLANT**

The Commission's main brief discusses in detail the real issues on this appeal. What we have there said fully answers the basic contentions of appellees and need not be repeated. The purpose of this reply brief is to correct certain major misconceptions which appear in appellees' brief and are sufficiently important to require re-emphasis.

1. Appellees incorrectly phrase the principal issue to be whether the Act purports to "regulate the sale by any stockholder of his stock in a service company or limit the price" (Br., p. 20). Having thus characterized the transaction in this case, appellees then argue at length that such sale does not, and cannot,

violate any fiduciary obligations of ISI and its directors and officers with respect to the Trust Fund under Section 36, since nowhere in the statute is there any express or implied provision regulating transactions in the stock of a service company (Br., pp. 30 ff., 47-49).

Such an approach, we submit, focuses attention merely upon the ostensible form of the transaction rather than upon essential realities. Since ISI performs fiduciary services for the Trust Fund and its directors and officers are likewise fiduciaries with respect to the Trust Fund, the real question is whether, in the guise of selling stock control, these fiduciary relationships have been exploited by the ISI directors and officers for their own benefit. Therefore, to observe that the Act does not purport to regulate the sale of stock in a "service company", as that term is used by appellees, does not dispose of our complaint. The established principles of equity forbid a fiduciary to capitalize on the fiduciary relationships, which is what we allege has occurred here as an intended consequence of the sale of stock. The Act conclusively establishes that advisory and principal underwriting contracts create fiduciary relationships, and Section 36 of the Act gives the Commission standing to enforce by court action the performance of fiduciary duties in this area.

In the instant case, the complaint specifically alleges that \$50 per share for the ISI stock did "not represent the real and actual value" of the ISI shares; that it "reflected the value of the perquisites and emoluments" which ISI derives from its agreements with

the Trust Fund; and that such agreements, being non-assignable, are not disposable assets of ISI (R. 9-10). We have no doubt that, as alleged in the complaint, the seller obtained, and the buyers paid, \$50 per share for the ISI stock, or over twenty-five times its net asset value, as the price for the strategic position of ISI and its directors and officers to dictate or influence the course of the succession to the underwriting and advisory relationship with respect to the Trust Fund. As thus understood, the transaction in this case can hardly be likened, as appellees suggest, to a sale by ISI of "its typewriters, its tables, or its sales organization to third parties" (Br. p. 49). See also pp. 45-48 of our main brief. Nor is this a case, as appellees suggest (Br., pp. 55, 59-61), which involves regulation or control over fees of ISI under existing contracts between ISI and the Trust Fund. This is a case in which appellee directors and officers have in effect sold the advisory and underwriting contracts for personal profit in violence to settled equitable principles. The sale of stock was merely the means by which this was accomplished.

2. Appellees argue that Section 36 of the Act should be narrowly construed and limited to cases of "self-dealing", namely, transactions between the investment company and the service corporation, directors, officers and others in similar positions (Br., p. 49 ff.). In support of their view, appellees quote extracts from the House and Senate Reports and from the testimony of Commissioner Healey (Br., pp. 49-51). These ~~con~~^{ex}tracts do not in terms deal with Section 36. They deal with the general problem of "self-dealing" between

the investment company and those who manage it. Undoubtedly, this was one of the major abuses which the Act was designed to remedy. Certain transactions between the investment company, its investment adviser, directors, officers, and other affiliated persons are now subject to Commission review and examination under Section 17 of the Act. It is rather curious that later on in their brief (p. 88) appellees state that cases of "self-dealing" which come under the ban of Section 17 "do not fall under Section 36." But there is nothing to indicate that Section 17 was intended to narrow the scope of Section 36.

Indeed, in enacting Section 36, the Congress intended that investment advisers, principal underwriters, directors, officers and others therein specified be held to fiduciary standards, and that the Commission have the standing and duty to enforce these standards in the civil courts. The reasons set forth in our main brief, pp. 26-31, 37-55, and the cases discussed at pp. 56-67, clearly indicate that the limitations which appellees seek to impose upon Section 36 are not supported by the text, its legislative history and the historic fiduciary principles enforced by courts of equity. In fact, when in an earlier draft "gross misconduct or gross abuse of trust" was declared "unlawful", the objection was made that under this broad standard a person would be subject to criminal penalties. When in the final draft, Section 36 was limited to a civil remedy for an injunction, the breadth and scope of the fiduciary standards and obligations encompassed within the terms "gross misconduct or gross abuse of trust" were not altered in any way. See our main brief, pp. 84-89.

In terms of the instant case, the trafficking in management contracts is a breach of fiduciary duty and therefore, on the facts, a gross abuse of trust. There is nothing to support the contention that "gross abuse of trust" in Section 36 does not extend to its full meaning in settled principles of equity. On the contrary, the legislative history reinforces the plain meaning of the section that the Commission may, through this type of civil action, enforce any aspect of fiduciary duty. And Congress was expressly concerned with the prevention of the trafficking in management contracts.

3. Appellees further argue (Br., pp. 37-48) that fiduciary standards under Section 36 are not applicable because the Congress provided a specific remedy. They refer to Section 1 (b) (6) which recites the evils resulting "when investment companies are re-organized, become inactive or change the character of their business, or when the control of management thereof is transferred, without the consent of their security holders." On the basis of this recital, appellees contend that to avoid the grave abuse resulting from the sale or transfer of management contracts (which we have detailed in our main brief, pp. 31-37), the Congress deemed it sufficient to provide in Section 15 that on sale or transfer of stock control the investment advisory and principal underwriting contracts are terminated and left it for investors to decide by vote whether or not to enter into new arrangements with the investment adviser or principal underwriter under different control. This argument fails to note that stockholder approval is neces-

sary for an attempted transfer where *no* unlawful consideration is involved. It is therefore unsound to reason that Congress intended stockholder approval to be sufficient to validate an attempted transfer where there is an unlawful consideration. However, we have discussed this contention at great length in our main brief (pp. 68–88), and no useful purpose would be served by repeating our arguments here.

4. Appellees argue by way of analogy (Br., pp. 57–58, 63–64), that stock of corporate fiduciaries, such as banks with trust departments, is freely sold in the market, and that there is no legal limitation on the price of the stock by reason of any value attributable to its earnings from its trust services.

Appellees cite no cases, and it may be that under some circumstances a sale of stock control of banks at a premium would involve a breach of trust. However, it is not necessary to resolve the laws relating to banks to resolve the instant case. Banks, both state and federal, have experienced a long history of special legal treatment both by courts and legislatures, and provide a body of law largely distinct from that relating to investment companies. With respect to the latter, the enforcement of fiduciary standards under Section 36, as we urge here, is clearly essential as a necessary corrective against past abuses and as an implementation of Congressional policy against trafficking in management contracts. Indeed, as noted in our main brief, pp. 34–35, purchase of stock control in the service company at a premium was one of the typical devices for trading in these fiduciary arrangements. If no such correctives are necessary with respect to banks,

it may be that past experience does not require it and regulation of banks under federal or state law may provide adequate safeguards. The Congress did not regard the two situations comparable. Section 3 (c) (3) expressly excludes from the definition of "investment company" and, hence, beyond the regulatory reach of the Act, "any bank or insurance company" and "any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian"

5. Although about 53% of the ISI stock was sold to the purchasers, of which about 40% represented stock owned by the four directors and officers of ISI, appellees argue that there was no sale of stock control (Br., pp. 94-97). Under Section 2 (a) (9), they state, presumptive control requires more than 25% of the voting stock, whereas in the present case no one person owned, sold or purchased as much as 25% of the ISI stock.

Section 2 (a) (9) makes clear that stock control is not necessarily based upon ownership of more than 25% of the voting stock. Such ownership creates a presumption of control. Less than 25% presumptively negatives control, but such presumption is rebuttable by evidence in the manner therein provided.¹ The

¹ Appellees' misconception that 25% of voting stock is the test of control underlies the "curious" distinctions as to the applicability of Section 36 (Br., p. 10). Appellees erroneously attribute these distinctions to the Commission and then label them as "fantastic" (Br., p. 11).

Commission's complaint specifically alleges that the sales of the ISI shares between February and July 1956—well over 25%—were effected pursuant to a plan (R. 8-9). See our main brief, pp. 88-89. We submit that the Commission is therefore entitled to the benefit of the statutory presumption in ruling on the present motion.

Appellees deny the existence of such plan or concert of action (Br., p. 97-104). They rely upon the affidavits of the buyers and sellers which include self-serving denials that there was a plan (R. 63, 69, 72, 74, 82, 84, 86, 87). It is these denials that appellees regard as sufficient to show the Commission's allegations to be a "sham" (Br., p. 97). They also assert that we "submitted no affidavits or showing tending to the contrary" (Br., pp. 97-98). This assertion ignores our affidavits (R. 106-112, 130-131), which are summarized in our main brief, pp. 7-10. They are based upon documentary proof and are not, and cannot be, denied by appellees.² See also our main brief, pp. 89-91.

At most appellees' denials tender issues of fact which the court below said are not reachable on a motion to dismiss or for summary judgment (R. 160), and decided the case on the assumption that, as alleged in the complaint, a transfer of stock control of ISI occurred (R. 146-147). In their discussion of the cases cited in our main brief, pp. 90-91, appellees ignore the pertinent ruling of this Court in *Lane Bryant, Inc. v.*

² Appellees hardly discuss the contents and thrust of our affidavits and label them as "irrelevant" (Br., p. 101). We are content to let the affidavits speak for themselves.

Maternity Lane, Ltd., 173 F. 2d 559, 565. The observations of the Third Circuit in *Toebelman v. Missouri-Kansas Pipe Line Co.*, 130 F. 2d 1016, 1022, are disposed of by a statement that that court "is notoriously out-of-step on the subject of summary judgment" (Br., p. 98, fn. 5).

6. Appellees contend that even if the transaction in this case constituted "gross misconduct or gross abuse of trust", ISI and its directors and officers are not persons within the reach of Section 36 (Br., pp. 73-81, 86-93). We have dealt with this contention in our main brief, pp. 91-103.

Appellees' contention that, even if an injunction may issue in this case, the court has no power to require an accounting for the pecuniary benefits derived by the individual defendants from their wrongful conduct (Br., pp. 81-84), is inconsistent with *Aldred Investment Co. v. SEC.*, 151 F. 2d 254, 261 (C. A. 1, 1945), *certiorari denied*, 326 U. S. 795 (1946). In that case, which arose under Section 36, the court said: "Section 36 invokes the equity power of the Federal court and that calls into play its inherent power where it is necessary to do justice and grant full relief." In that case, the court issued the injunction provided in Section 36 and in addition upheld the power of the district court to appoint a receiver for the investment company. In a subsequent appeal the court held that the district court had power to direct liquidation or reorganization of the investment company where such a course appeared in the best interest of investors, *Bailey v. Proctor*, 160 F. 2d 78, 81-83 (C. A. 1, 1947), *certiorari denied*, 331

U. S. 834 (1947). An accounting for the profits to the Trust Fund, which is a party to these proceedings, is merely incidental to the statutory relief expressly prescribed by Section 36. The power of the district court, as a court of equity, in this respect is beyond dispute. See *Porter v. Warner Holding Company*, 328 U. S. 395 (1946).

7. Appellees argue that count two of the complaint alleging violation of the Commission's Proxy Rules is now moot since the meeting of investors has been held and the proxies have been voted (Br. 105-106). They ignore the fact that the Commission brought this action before the meeting of investors and sought a preliminary injunction to restrain the voting of the proxies on the proposed investment advisory and principal underwriting contracts (R. 14-15). At the meeting of investors held on August 15, 1956, the proxies were not voted on these proposed contracts and other matters under the Interlocutory Order of the court, dated August 14, 1956, (R. 48-49), and the meeting was adjourned. Under the Second Interlocutory Order, filed August 30, 1957, the Commission withdrew its motion for a preliminary injunction upon the express condition, *inter alia*, that this was without prejudice to appropriate relief with respect to the investment advisory and principal underwriting contracts if it is determined in a final decree that the Commission was entitled to judgment. If, as we urge, the proxies have been unlawfully solicited and the existing contracts between ISI and the Trust Fund have been terminated because of the sale of stock control of ISI, ISI has been acting as invest-

ment adviser and principal underwriter in violation of Section 15 (See pp. 39-42 of our main brief). Appropriate relief against this violation is clearly in order.

Appellees' contention that ISI's proxy solicitation material was not false and misleading and that there were no material omissions of fact (Br., pp. 106-114) are fully discussed in our main brief, pp. 103-111.³

CONCLUSION

The relief as set forth in our main brief, pp. 111-112, should be granted.

Respectfully submitted.

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OCTOBER 1957.

³ One of the Commission's contentions is that since the sale of stock control involved a breach of trust under Section 36, the proxy material was false and misleading in having characterized the consequence of the sale as "technical", namely, the termination of the contracts under Section 15. Appellees state (Br., p. 109) that this is an afterthought, and that it did not appear in the original or amended complaint. They ignore paragraph 30 of the Commission's complaint (R. 12-13).

1. The above information is being furnished to you for your information and is not to be used for any other purpose.

are fully discussed in the preceding chapters.

Respectfully,
Yours truly,
J. Edgar Hoover

No. 15457

**United States
Court of Appeals**
for the Ninth Circuit

**SECURITIES AND EXCHANGE COMMIS-
SION,**

Appellant,

vs.

**INSURANCE SECURITIES INCORPORATED,
TRUST FUND SPONSORED BY INSUR-
ANCE SECURITIES, INCORPORATED,
ABE P. LEACH, OSSIAN E. CARR, AR-
THUR J. LONERGAN, ROY A. HAIGHT
and LELAND M. KAISER, as Attorney and
Proxy for Investors of Trust Fund,**

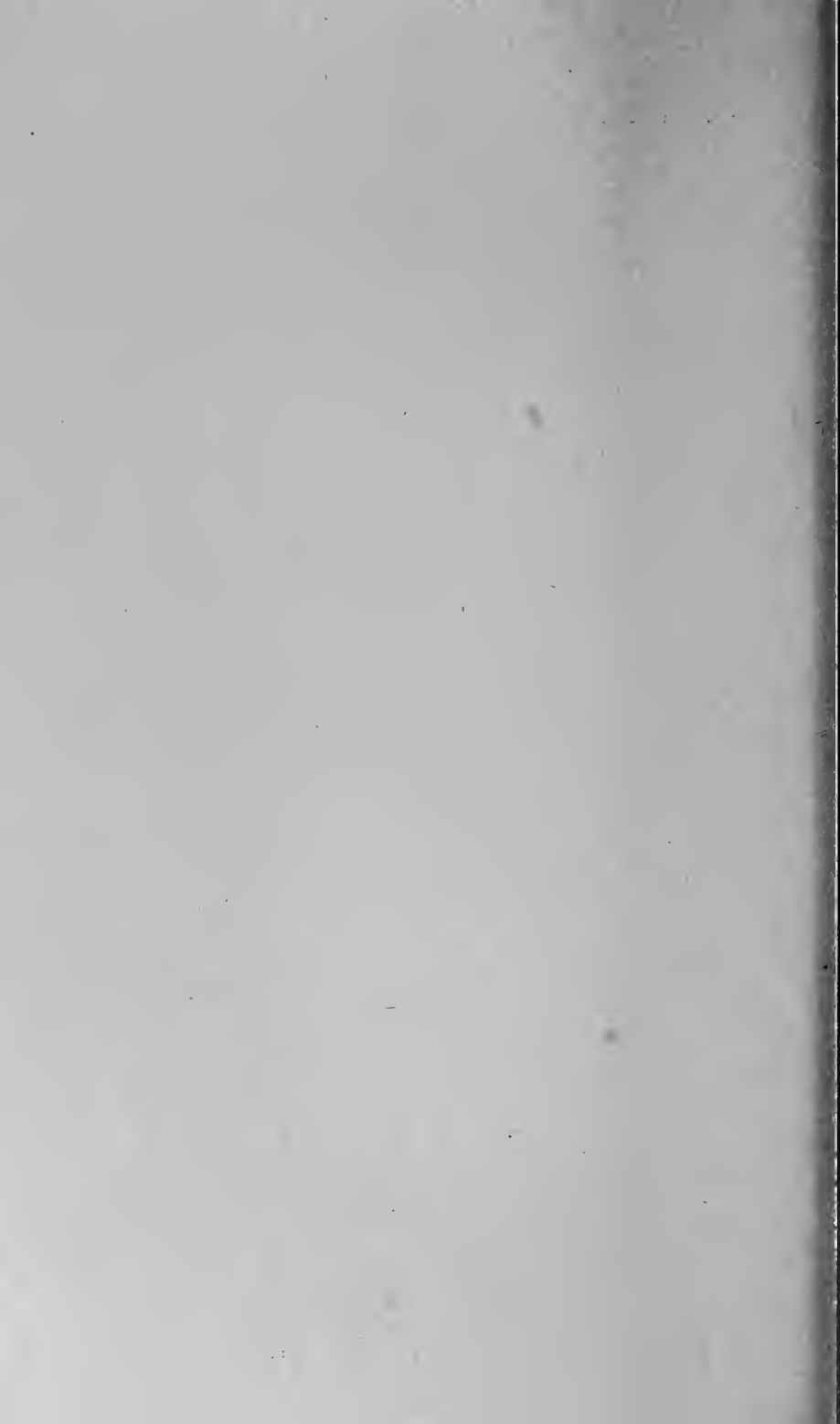
Appellees.

**Transcript of Record
FILED**

**Appeal from the United States District Court for the
Northern District of California.
Southern Division.**

MAY - 8 1957

PAUL P. O'BRIEN, CLERK



No. 15457

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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United States District Court for the Northern
District of California, Southern Division

Civil Action No. 35764

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

INSURANCE SECURITIES INCORPORATED,
TRUST FUND SPONSORED BY INSURANCE SECURITIES, INCORPORATED,
ABE P. LEACH, OSSIAN E. CARR, ARTHUR J. LONERGAN, ROY A. HAIGHT
and LELAND M. KAISER, as Attorney and
Proxy for Investors of Trust Fund,

Defendants.

COMPLAINT

It appearing that the defendant individuals named hereinafter have engaged, and may continue to engage, in acts and practices which constitute gross misconduct and gross abuse of trust within the meaning of Section 36 of the Investment Company Act of 1940 ("the Act"), 15 U.S.C. 80a—35; and it appearing further that said individuals and others have engaged, and will continue to engage, in acts and practices in violation of the proxy regulations under Rule N-20A-1, promulgated under Section 20(a) of the Act, 15 U.S.C. 80a—20(a); the Securities and Exchange Commission ("the Commission") brings this action to enjoin such acts

and practices and further violations of the Act and the Commission's Rules and Regulations thereunder, and for other appropriate and equitable relief.

This action is brought before this Court pursuant to Sections 42(e) and 44 of the Act, 15 U.S.C. 80a—41(e) and 43.

First Cause of Action

1. Insurance Securities Incorporated ("Insurance Securities") was organized on March 9, 1938, under the laws of California. Its principal business office is located at 2030 Franklin Street, Oakland, California.

2. The following individuals defendants have been and continue to act as directors, and in addition hold the following offices of Insurance Securities:

Name	Office
Abe P. Leach.....	President
Ossian E. Carr	Vice-President
Arthur J. Lonergan	Vice-President
Roy A. Haight	Secretary

These individuals have been directors since 1938. They are also members of the Executive Committee of Insurance Securities. Their principal business office is: 2030 Franklin Street, Oakland 12, California.

3. Leland M. Kaiser has been a director and vice-president of Insurance Securities. He is made

a party defendant herein in his capacity as proxy and attorney on behalf of investors of a "Trust Fund" as hereinafter more fully described. His business address is Russ Building, San Francisco 4, California.

4. Insurance Securities is the Sponsor, Depositor, Investment Adviser and Principal Underwriter of a "Trust Fund." Insurance Securities has no other business.

5. The Trust Fund was organized under California law under the terms of a Trust Agreement dated July 1, 1938, and as subsequently amended. The principal office of the Trust Fund is at 2030 Franklin Street, Oakland 12, California.

6. The Trust Fund is an open-end diversified management company within the meaning of Sections 4 and 5 of the Act, 15 U.S.C. 80a—4 and 5, and is registered as such with the Commission pursuant to Section 8(b) of the Act, 15 U.S.C. 80a—8(b).

7. The Trust Fund derives its capital funds from the continuous offerings to public investors of Participation Agreements. Such participations are sold either under a single payment plan involving a single investment of \$1,000 or more, or under a periodic payment plan with monthly payments of \$10 or more, and a \$1,200 minimum aggregate covering a 10-year period. The net receipts are invested by the Trust Fund in stocks of various insurance companies. As of December 31, 1955, net assets of

the Trust Fund amounted to approximately \$215,000,000.

8. The Trust Fund has no officers or directors of its own. Management functions are discharged by Insurance Securities as Sponsor, Investment Adviser of said Trust Fund.

9. Insurance Securities receives a "creation fee," or sales load, for the sale of Participation Agreements. It receives also a fee for administering the Trust Fund, and a management and investment supervisory fee for investment advice. During the fiscal years ended June 30, 1953, 1954 and 1955, Insurance Securities received as follows:

	1953	1954	1955
Creation Fees	\$1,847,948	\$2,960,222	\$4,354,300
Administrative Fees	165,432	224,452	276,724
Advisory Fees	97,687	134,009	166,357
Other	710	884	1,126
Total	<u>\$2,111,777</u>	<u>\$3,319,567</u>	<u>\$4,798,507</u>

10. The investors in the Trust Fund have no general voting rights, except in the particular circumstances specified in the Trust Agreement. Among other things, said Trust Agreement provides, as required by the Act, that the Trust Fund's advisory and principal underwriting contracts must be approved annually by a vote of investors representing a majority of investment units of the Trust Fund.

11. Under the Trust Agreement, as also required by the Act, an assignment of the contract

to serve as Investment Adviser for the Trust Fund automatically terminates such contracts. The Trust Agreement also provides, as further required by the Act, that an assignment of the contract to engage in the Principal Underwriting of the securities of the Trust Fund automatically terminates the contract. Section 2(a)(4) of the Act, 15 U.S.C. 80a—2(a)(4), defines the term “assignment” to include

“any direct or indirect transfer * * * of a contract * * * by the assignor, or of a controlling block of the assignor’s outstanding voting securities by a security holder of the assignor.”

12. On or about January 1, 1956, and for some years prior thereto Insurance Securities had outstanding 166 shares of capital stock, \$100 par value. This stock was closely held, of which 72% was held in the aggregate by the individual defendants, Leach, Carr, Lonergan and Haight (hereinafter referred to as the “director-defendants”).

13. On June 29, 1956, the outstanding capital stock of Insurance Securities was split into 166,000 shares, 10c par value. For purposes of convenience, the amount held by each of the persons named hereafter and the amount of such stock sold will be given in terms of their equivalents after June 29th.

14. On January 1, 1956, each of the director-defendants owned 30,000 shares, or 18% of the 166,000 shares outstanding.

15. The balance of the stock was held by five individuals: Elwood H. Smith, 26,000 shares, or 16%

of the total outstanding; Hazel E. Plant, 15,000 shares, or 9% of the total outstanding; Donald B. Rice (a director), 1,000 shares, or 0.6% of the total outstanding; and McConnell and W. Smith, 2,000 shares each, or 1.2% of the total outstanding. It is represented to the Commission that Rice bought his shares in January, 1955, and that McConnell and W. Smith acquired their shares by gift in December, 1955.

16. Upon information and belief, on or about February 1, 1956, the director-defendants either alone or in concert with others, embarked upon a plan to sell their stock interests to a small number of purchasers, affiliated among each other through stock ownership and otherwise. Most of said sales were arranged through Kaiser & Co., investment bankers in San Francisco, California. Leland M. Kaiser, a member of the firm, is now a director and vice-president of Insurance Securities. He has also been designated as one of the Attorneys and Proxies for the investors at the forthcoming meeting of the investors of the Trust Fund, the purpose of said meeting is to vote upon matters more fully described below. It is contemplated that Leland M. Kaiser will succeed A. P. Leach as president of Insurance Securities.

17. The total shares of the capital stock of Insurance Securities sold to the purchasers between February 1, 1956, and July 1, 1956, inclusive, amounted to 88,000 shares, or 53% of the shares outstanding.

18. During the same period, the director-defendants sold to the purchasers the following number of shares:

Leach	29,000 shares
Carr	13,000 shares
Lonergan	13,000 shares
Haight	13,000 shares

By reason of the aforesaid transfers, the director-defendants reduced their stock interests in Insurance Securities from 72% to 31.2%. The amount thus transferred to the purchasing group amounted to about 40.8% of the total outstanding. The balance of approximately 13% were purchased from the other individual holders except Rice.

19. The price paid for the stock was \$50 per share. The balance sheet as of June 30, 1956, for Insurance Securities, attached hereto as Exhibit A, shows the stockholders' equity in this company to be \$300,489, or \$1.81 per share. The aggregate price for the total shares sold was approximately \$4,240,720 in excess of their net book value.

20. The price of \$50 per share paid, and agreed to be paid, to the sellers does not represent the real and actual value of the Insurance Securities shares. The payment of 25 times the net asset value represented no payment for any asset or assets owned by Insurance Securities. Ostensibly and necessarily, the purchase price reflected the value of the perquisites and emoluments which Insurance Securities derives from the substantial fees paid, and to be

paid, by the Trust Fund to Insurance Securities under the Investment Advisory and Principal Underwriting contracts, which under the Trust Agreement and under the Act, as noted in paragraph 11, *supra*, are not assignable. The value attached to said contracts are an asset of the Trust Fund, and in law and equity is preserved for the benefit of such Trust Fund.

21. Insurance Securities, by virtue of its pervasive management position with respect to the Trust Fund, and its directors and officers, including the director-defendants, stand in a fiduciary relationship to said Trust Fund, and in law and equity cannot profit on trading on such fiduciary relationship. The substantial profits realized and to be realized, by the director-defendants, as aforesaid, represent profits which equitably belong to the Trust Fund but which, upon information and belief, said director-defendants intend to keep, for their own account and benefit.

22. Upon information and belief, in further pursuit of their unlawful conduct, the directors of Insurance Securities, including the director-defendants, commenced solicitation of proxies for a meeting of investors of the Trust Fund. Said solicitation commenced shortly after the stock transactions hereinabove described.

23. The object of the proxy solicitation and the meeting of investors is set forth in the proxy soliciting material attached hereto as Exhibit B.

24. Among other things, the object of the meeting is to reinstate or to confirm the Investment Advisory and Principal Underwriting contracts which the Commission believes have been terminated by reason of the transfer of control, as described hereinabove, and which it is stated in the proxy soliciting material may have such effect. By obtaining reinstatement and confirmation of said contracts, the purchasers of the controlling stock interest in Insurance Securities would be assured of the benefits of said contracts, for which they paid substantial sums, and the director-defendants would be assured of their inequitable profits as a consequence of the sale of such contracts.

25. By reason of the foregoing, the director-defendants are guilty of "gross misconduct" and "gross abuse of trust" within the meaning of Section 36 of the Act.

Second Cause of Action

26. Plaintiff alleges and incorporates by reference matters set forth in paragraphs 1 to 25, inclusive.

27. On or about July 17, 1956, Insurance Securities caused to be mailed to investors of the Trust Fund proxy soliciting material and a form of proxy for the purpose of a meeting of investors of the Trust Fund, scheduled for Wednesday, August 15, 1956, at 10:00 a.m. Pacific Daylight Saving Time. The solicitation is being made by Insurance Securities as "Sponsor and Manager, and as

Investment Advisor and Principal Underwriter, of the Trust Fund.” The cost of the solicitation is to be borne by Insurance Securities.

28. The purpose of the meeting is to vote on several proposals devised and formulated by Insurance Securities. Among these is a proposal to reinstate or confirm by a majority vote of investors the Investment Advisory and Principal Underwriting contracts. In the proxy statement it is alleged that the “company is advised” that the “change in majority ownership” of Insurance Securities stock “may be considered an assignment” of said contracts by the terms of the contracts and under the Act. The Commission alleges that under the facts and circumstances here presented such contracts have been terminated.

29. The aforesaid proxy solicitation material is false and misleading and in violation of Section 20(a) of the Act and Rule N-20A-1 (17 C.F.R. 270.20a-1), which incorporates by reference and makes applicable to registered investment companies the Commission’s proxy rules set forth in Rule X-14A (17 C.F.R. 240.14).

30. The proxy soliciting material states that the company is advised, presumably by its counsel, that the change in majority ownership of the Insurance Securities stock may have the technical effect of terminating the Investment Advisory and the Principal Underwriting contracts, when in effect the company has also been advised by the staff of the

Commission that, on the facts presented, the change in majority ownership may also involve gross misconduct and gross abuse of trust under Section 36 of the Act.

31. The proxy solicitation material is also misleading in that it omits to state the price paid to the director-defendants for their stock of Insurance Securities.

32. Insurance Securities and its directors were, and are, under an obligation to disclose the foregoing facts and circumstances, in the light of which an investor may determine and vote on whether or not to reinstate the Investment Advisory and Principal Underwriting contracts for which the new controlling group and persons have paid substantial amounts of money.

33. Another proposal to be submitted to the investors of the Trust Fund for their vote and approval is the setting up of a board of trustees for the Trust Fund to be known as a "Board of Directors" and the election on staggered terms of such board of directors. Among the nominees for this board of directors are Leach and Haight, two of the individual defendants who are now directors of Insurance Securities.

34. This Court has jurisdiction to enjoin the holding of the proposed meeting of the investors of the Trust Fund, to the extent of restraining a vote on the aforesaid proposals, and thus prevent exer-

cise of proxies procured in violation of the Act and the Commission's Rules and Regulations thereunder.

Wherefore, plaintiff requests that a judgment be entered by this Court granting

(1) A permanent injunction enjoining the individual defendants from serving as officers and directors of Insurance Securities Incorporated, and from serving and acting as directors of the proposed board of directors of the Trust Fund;

(2) A permanent injunction restraining all of the defendants, their agents, employees and nominees, from voting proxies, obtained pursuant to the proxy solicitation material circulated by Insurance Securities Incorporated, at the forthcoming meeting of investors of Trust Fund to be held on August 15, 1956, or at any adjournment or adjournments thereof;

(3) Pending a final determination of this action, and subject to further order of this Court, that the defendants be temporarily enjoined from voting the proxies at the forthcoming meeting of investors of the Trust Fund scheduled for August 15, 1956, or any adjournment or adjournments thereof, in respect of:

(a) The proposed reinstatement of the Investment Advisory and Principal Underwriting contracts;

(b) The setting up of a board of directors for the Trust Fund and the election of such directors scheduled at the same meeting;

(4) Pending final determination of this action, and until further order of this Court, that the amount of fees to be charged by Insurance Securities Incorporated for its Investment Advisory and Principal Underwriting services in excess of actual costs or expenses thereof be segregated and maintained in a separate account;

(5) That an accounting be rendered by the director-defendants in this cause for the inequitable and wrongful profits realized, and to be realized, as a consequence of the sale of their stock of Insurance Securities Incorporated;

(6) Such other, further and different relief as this Court may deem just and proper.

/s/ THOMAS G. MEEKER,
General Counsel.

/s/ AARON LEVY,

/s/ E. KENNAMER,
Attorneys, Securities and
Exchange Commission.

Dated: August 10, 1956.

EXHIBIT A

Insurance Securities Incorporated

Balance Sheet—June 30, 1956

Assets

Current Assets:

Cash\$533,379.60

Investment in participating agree-
ments—at liquidating value—

adjusted cost basis \$266,542.00 331,204.93

Miscellaneous receivables 8,097.65

Prepaid expenses 36,188.58

Total current assets

\$ 908,870.76

Notes Receivable

43,070.00

Fixed Assets:

Office furniture and equipment....\$238,298.38

Less accumulated depreciation 68,604.50

Remainder\$169,693.88

Leasehold improvements—

Unamortized balance 5,480.15

Total fixed assets

175,174.03

Total assets

\$1,127,114.79

Liabilities and Stockholders' Equity

Current Liabilities:

Accounts payable\$ 5,961.22

Accrued salaries 24,734.75

Payroll taxes collected and
accrued 19,995.34

Federal taxes on income..... 605,630.24

Overpayments made by investors 474.01

Dividends declared to
stockholders 149,400.00

Advance rent received 4,265.00

Total current liabilities

\$ 810,460.56

Provision for Federal Income Tax on Unrealized Appreciation of Investment in Participating Agreements		\$ 16,165.73
Stockholders' Equity:		
Capital stock* — authorized 500,000 shares—par value ten cents per share; issued and out- standing 166,000 shares	\$ 16,600.00	
Capital received for shares in excess of par value.....	14,400.00	
Retained earnings	220,991.30	
Subtotal	\$251,991.30	
Unrealized appre- ciation of par- ticipating agree- ments	\$64,662.93	
Less applicable federal income tax which would ac- crue	16,165.73	48,497.20
Stockholders equity		300,488.50
Total liabilities and stock- holders' equity		\$1,127,114.79

This Statement is Unaudited.

*Effective June 29, 1956, par value of shares reduced to 10c and stock split 1,000 shares for each share of \$100.00 par value stock.

EXHIBIT B

“Definitive Copy”

[Handwritten]: 8 11-87-2—Orig.

Insurance Securities Incorporated
Trust FundExecutive Offices: 2030 Franklin Street
Oakland 12, California—Glencourt 1-2442

Roy A. Haight, Secretary

July 17, 1956.

To the Investors Holding Participating Agreements
in the Trust Fund

Gentlemen:

In connection with action proposed upon certain amendments to the Amended Trust Agreement under which the Participating Agreements are outstanding, you will find enclosed herewith the following:

- (1) Formal Notice of Meeting.
- (2) Notice of Proposed Supplemental Agreements with copy of the Proposed Supplemental Trust Agreement attached thereto.
- (3) Proxy Statement covering the matters referred to herein.
- (4) Proxy (ballot).

The amendments to be acted upon involve (a) creation of a Board of Trustees or Directors for the Fund, to be elected by the Investors, to whom Insurance Securities Incorporated will be responsible in its Investment Advisory and Underwriting functions; (b) enlargement of the list of eligible companies available for the investment of the Trust Funds; (c) simplification of procedures by which the investor designates or changes a beneficiary or assigns a Participating Agreement, and (d) reinstatement of the Investment Advisory and Principal Underwriting Contracts between Insurance Securities Incorporated and the Trust Fund in precisely the present form, except as affected by the creation of a Board of Directors of the Fund.

The Proxy Statement and Notice of Proposed Supplemental Agreement set forth in more detail the matters to be acted upon and the reasons therefor, and the Proxy which is enclosed provides appropriate spaces in which you may direct the manner in which your vote is to be cast.

There is to be no relaxation of the present limitations relating to the qualifications of a company for investment of the trust funds in its securities. However, because of the size and growth of the Fund, it is believed desirable that a large market of eligible securities be maintained so that available funds may always be invested to the greatest advantage of the investors. As new companies qualify under the limitations contained in our Articles, and become desirable investment for Trust Funds, we

feel that such companies should be made eligible for Trust portfolio investment, and it is for this reason that the additional securities are presented for your approval. This is in accordance with our past procedures; as you will recall during 1954 you approved the addition of 25 companies and deleted 5 from the eligible list.

The simplifications of procedures are designed to modify requirements of the Company relative to the assignment of Participating Agreements and designations of beneficiaries thereunder. Certain of the present requirements, particularly the requirements of a marital affidavit upon assignment or change of beneficiary, have proved cumbersome and the Company is taking these steps to improve and simplify such procedures.

It is believed that the provision creating a Board of Trustees or Directors elected by the investors and directly responsible to them is a desirable change in that it places the responsibility for management upon persons who have been chosen by the investors themselves. At the same time, all the advantages of the relationship with Insurance Securities Incorporated are retained through the Investment Advisory and Underwriting Contract.

As will be noted in the Proxy Statement, Mr. Leach, who is now reaching his eighty-third birthday, is relinquishing his position as President of the Company and accepting in its place a somewhat less active role as Chairman of the Board of Directors

of the Company. At the same time, however, he is being proposed as a member of the Board of Trustees of the Fund.

In connection with Mr. Leach's semi-retirement, he is selling substantially all of his stock of the Company to other stockholders. As explained in the Proxy Statement, this sale, together with other sales of stock made in the past, may have the technical effect of terminating the Investment Advisory and Underwriting Contracts of the Company under the Trust Agreement. Therefore, these contracts are submitted to the investors for reinstatement.

The provisions governing the investment of available funds, and the policies of the Company as set forth in the Trust Agreement will, of course, not be changed or affected by the transfer of ownership. Changes of such character, as well as changes in securities eligible for investment of trust funds will, in any event, require consent of a majority of the holders of Participating Agreements.

May we urge that these proceedings are important, both to the Company and to yourself, and that you indicate your desires without delay. The entire expense of this solicitation is being borne by the Company, without cost to the Investors. To remove any confusion with regard to the information shown in the Proxy Statement relating to the Officers and Directors of Insurance Securities Incorporated, we may state that none of the compensation shown therein is paid directly by the Trust Fund to such

persons. The sums received by the Officers and the Directors of this Company are paid by the Company out of the fees allowed the Company as set forth in the Statement and are not in addition thereto.

Your prompt co-operation in this matter will be greatly appreciated.

Your very truly,

/s/ R. A. HAIGHT,

Secretary, Insurance

Securities Incorporated.

[Stamped]: Received July 16, 1956, U.S.S.E.C.

“Definitive Copy”

Insurance Securities Incorporated

Proxy Statement

To the Investors Holding Participating Agreements
in the Trust Fund:

Herewith you will find notice of Proposed Supplemental Agreement which contains certain proposed amendments to the Amended Trust Agreement between Insurance Securities Incorporated, Pacific National Bank of San Francisco, Trustee, and the Investors, together with a Notice of Meeting of Investors to be held at The Bowl, Hotel Leamington, 19th and Franklin Streets, Oakland, California, and a form of Proxy. It is important that you sign, date and return this Proxy now.

Voting of Proxies

The Participating Agreements represented by all properly executed Proxies received in time for the meeting will be voted. Where an Investor has specified a choice by marking the ballot provided in the Proxy, the Participating Agreements represented by that Proxy will be voted in accordance with the specification made. If no specification is made, the investment units represented by such Participating Agreements will be voted in favor of the proposals referred to in the Notice of Meeting. Discretionary authority is granted in the Proxy to vote on any matters, other than those referred to in the Notice of Meeting, which may properly come before the meeting or any adjournment thereof. The management of Insurance Securities Incorporated knows of no such matters which are to be presented for action at the meeting.

The giving of the enclosed form of Proxy does not preclude the right to vote in person should you so desire. The Proxy may be revoked before it is exercised but will continue in full force and effect until an instrument revoking it, or a duly executed Proxy bearing a later date is filed with the Secretary of the Corporation.

Outstanding Participating Agreements

The aggregate amount of all Participating Agreements issued and outstanding as of June 30, 1956, was \$223,150,664, representing an aggregate equity in the Trust Fund of 94,074,860.562 investment

units. Investors of record as at the close of business on July 16, 1956, will be entitled to vote at said meeting.

Solicitation and Cost Thereof

This solicitation is being made by Insurance Securities Incorporated (the "Company") as the Sponsor and Manager, and as Investment Advisor and Principal Underwriter, of the Trust Fund. The cost of preparing, assembling and mailing all matter connected with this solicitation will be borne by Insurance Securities Incorporated.

Proposed Amendments to the Amended Trust Agreement

The amendments proposed to be made are set forth in full in the Notice of Proposed Supplemental Agreement, to which reference is made for a complete statement of the terms thereof. If such amendments are approved at the meeting they will become effective, not earlier than 60 days from the date hereof nor more than 10 days thereafter, upon the taking of certain formal steps required in the Amended Trust Agreement. The more important aspects of, and the purpose of, each of the proposed amendments may be briefly described as follows:

As to the First Proposed Amendment:

In order that the Trust Fund may be managed by a Board elected by the Investors and directly responsible to them, it is proposed that the Trust

Agreement be amended so as to provide for a board of trustees to be known as the "Board of Directors" which would be entrusted with the management of the business and affairs of the Trust. Duties heretofore performed by the Company would thereafter be performed by it, subject to the control, supervision and direction of the Board of Directors. In addition, certain functions delegated to the Trustee would thereafter be performed subject to the direction of the Board of Directors.

It is proposed that the Board of Directors of the Trust consist of Mr. Abe P. Leach, Mr. Leland M. Kaiser, Mr. Roy A. Haight, Mr. Brayton Wilbur, Mr. Howard Ainsworth, Judge A. J. Woolsey and Mr. E. R. Leach, all of whom are presently Directors of Insurance Securities Incorporated. Mr. Abe Leach and Mr. Kaiser would each serve for an initial term of five years, Mr. Wilbur for a term of four years, Mr. Haight and Mr. E. R. Leach for terms of three years and Judge Woolsey and Mr. Ainsworth for terms of two years and one year, respectively. Upon the expiration of the term of each Director, a successor would be elected who would then hold office for five years. Messrs. Wilbur, Ainsworth, Woolsey, and E. R. Leach will resign as Directors of the Company upon election as Directors of the Fund.

Under the proposed amendment, the Directors would each receive as compensation an amount equal to the fees paid by the Company to each member of its Board of Directors. Such compensation will be

deducted, however, from the amounts payable to Insurance Securities Incorporated under the terms of the Investment Advisory and Principal Underwriting contracts and hence will not add any additional expense to be charged against the Trust Fund.

No Director shall be liable for any action which he may in good faith, or on the advice of counsel, take or refrain from taking in connection with his duties.

One effect of the proposed amendment will be that a majority of the members of the Board of Directors who are not parties to such contracts or otherwise affiliated with the Company, as well as the Investors, will have the power to approve, annually, the contract between Insurance Securities Incorporated, Pacific National Bank of San Francisco, and the Investors concerning matters of Investment Advising and Principal Underwriting.

As to the Second Proposed Amendment:

The additional companies named in the amendment, approval of which is now sought, are, in the judgment of the Company, all desirable companies. Each of these companies has been in operation for more than fifteen years; each has paid dividends for each of the last preceding five (5) years or more and each has assets of more than seven million dollars.

In addition, by increasing the number of insurance companies, shares of the capital stock of which

may be purchased, a larger number of qualified companies will be afforded from which selection for purchase may be made, with due regard to the various elements of desirability, such as the relation of price to asset value, yield, management, and previous performance. Furthermore, the trend in the insurance industry is toward consolidation. It is possible, if not probable, that through consolidation the number of companies, the shares of the capital stock of which are eligible for investment, may be reduced below the number now eligible.

The list of companies the shares of capital stock of which are eligible for investment, as it presently exists, contains the names of three companies which should be deleted, namely, American Alliance Ins. Co., Automobile Insurance Co. of Hartford, Conn., and Central Surety and Insurance Corporation of Kansas City, Mo. These companies have been acquired by other companies and their capital stock is no longer available. Your attention is also called to the fact that the company designated as Peerless Casualty Company in the list has changed its name and is now known as Peerless Insurance Company. The portfolio has been revised to reflect such change in name.

As to the Third Proposed Amendment:

Designation of a beneficiary (other than spouse or estate), or a change of beneficiary, by a married Investor now requires the consent of the spouse, together with an affidavit of marital status. The pro-

visions are applicable without regard to the separate or community character of the investment and, as a result, have caused a great deal of concern to certain Investors where separate property was involved; and they have occasionally proved an unnecessary hardship upon the Investor. The amendment is designed to eliminate these requirements.

As to the Fourth Proposed Amendment:

An assignment of a Participating Agreement requires the consent of the spouse of a married Investor and the submission of an affidavit of marital status. Securing such documents has often proven to be an inconvenience to, and a hardship upon the Investor, and is in excess of the requirements of ordinary business practice, particularly in matters involving assignment by way of collateral security. Here, too, the requirements disregard the separate or community character of the investment. The amendment is designed to eliminate these requirements.

As to the Fifth and Sixth Proposed Amendments:

The Amended Trust Agreement contains all of the terms of a contract between the owners of the Trust Fund and Insurance Securities Incorporated concerning matters of Investment Advising and Principal Underwriting.

The rights and obligations of the Company in these regards are, briefly, as follows:

1. Investment Advising

(a) The Company shall order the securities and the amount or number thereof which shall be purchased or sold.

(b) Neither the Board of Directors of Company nor any officer or member thereof, shall directly or indirectly purchase or otherwise acquire from the Trust property any stocks or other securities acquired by the Company or Trustee for or on behalf of the Investors nor shall there be purchased by the Company for the Trust, directly or indirectly, any stocks or other securities owned by any officer, director or stockholder of the Company, or in which they or any of them have any interest.

(c) The Company shall receive no compensation for its services as said Investment Adviser as said term is defined by and in the Investment Company Act of 1940, except insofar as a compensation therefor may be included in the Investment Supervision and Management fee and Administrative fee. Said fees are as follows for each \$1,200.00 paid or agreed to be paid, per month:

	Accumulative Plan	Single Payment Plan
Administrative Fee28	.18
Investment Supervision and Management10	.20
Total	<u>.38</u>	<u>.38</u>

Except that, starting with Participating Agreements issued after August 1, 1949, the total of said

fees deducted, including the Trustee's Fee, in no case shall be more than $1/12$ of 1% of the net payments invested, and in any case where the fees charged shall be less than above, the actual fee as charged shall be in the same proportion and any excess shall be waived without right of subsequent reimbursement or payment thereof.

(d) The right and obligation of Company to act as Investment Adviser shall continue until terminated, provided, however, that it shall continue for a period of more than two years from its effective date only so long as such continuance is specifically approved at least annually by the Board of Directors or by vote of the holders of a majority of investment units of all outstanding Participating Agreements.

(e) The right and obligation of Company to act as such Investment Adviser may be terminated at any time, without the payment of any penalty, by the Board of Directors or by the vote of the holders of a majority of the investment units of the outstanding Participating Agreements on not more than sixty days' written notice to Company.

(f) Any assignment by Company of its rights to act as Investment Adviser of the Trust Fund shall automatically terminate and end its rights to so act from and after the date of such assignment, and no rights or privileges shall be conveyed by virtue of said assignment.

2. Principal Underwriting

(a) Company as agent of the Trust Fund has the right to sell Participating Agreements issued under the provisions of the Trust Agreement.

(b) All subscriptions for the issuance of Participating Agreements shall be in such form or forms as Trustee and Company may from time to time prescribe.

(c) When such subscription agreement is signed and delivered by Investor to Company or its agent, it shall be accompanied by the first payment provided for therein, which payment shall be known as the "Initial Payment," which may be in any amount up to the full amount agreed to be paid, but shall not be less than \$120.00 upon each unit of \$1,200.00. The remainder of the face amount of the Participating Agreement to be issued pursuant to a subscription therefor under the Accumulative Plan shall be payable in equal installments, each payable on such date as the subscriber shall designate in such subscription, until the total face amount of the Agreement is paid. Investor may pay any payments in advance.

(d) Company has the right to reject any subscription made to it for the issue of an Agreement or of Agreements.

(e) Each of the Investors authorizes and directs Company to charge to Investor's account and to deduct a Creation Fee or Sales Load in a sum equal to 8.85 per cent (8.85%) of the amount paid on each

Single Payment Participating Agreement, and 8.85 per cent (8.85%) of the amount agreed to be paid on each Accumulative Plan Participating Agreement. In the case of the Accumulative Plan, however, the Creation Fee or Sales Load shall be deducted as follows: 7.48 per cent (7.48%) of the required first twelve monthly payments or their equivalent, and nine per cent (9%) on the balance of the aggregate amount agreed to be paid when, as, and if said payments are made.

(f) The right and obligation of Company to act as Principal Underwriter to offer for sale, sell or deliver after sale any security issued by it shall continue until terminated; provided, however, it shall continue for a period more than two years from its effective date only so long as such continuance is specifically approved at least annually by the Board of Directors or by vote of the holders of a majority of investment units of all outstanding Participating Agreements.

(g) Any assignment of its rights to act as Principal Underwriter of such securities shall automatically terminate and end its right to so act from and after the date of such assignment, and no rights or privileges shall be conveyed by virtue of said assignment.

Present Investment Adviser and Underwriter

Insurance Securities Incorporated is now acting and has acted as Investment Adviser, in determining which of the eligible Insurance Stocks were to

be purchased and which of the portfolio securities were to be sold, since the inception of the Trust Fund and also as Principal Underwriter of the Participating Agreements issued since the inception of the Trust Fund.

Mr. Leach now proposes to retire as the chief executive officer of the Company and will assume the less active role of Chairman of the Board. At the same time he advises us that he is selling substantially all of the balance of the stock of the Company which he holds, amounting to 10.24% of the stock of the Company, to other stockholders of the Company. Upon the consummation of this sale, the old stockholders of the Company, being those who have held stock for over 16 years, will hold less than a majority of its shares, to be precise 45.78% thereof, and the Company is advised that this change in majority ownership may be considered an assignment of the contract between the owners of the Trust Fund and the Company concerning matters of Investment Advising and Principal Underwriting, as defined in the Investment Act of 1940. Under the terms of such contract and such Act, a termination of the contract takes place upon its assignment.

The sale by Mr. Leach of his stock, while not conditioned on the approval by the Investors of the proposed Supplemental Trust Agreement, is to be synchronized with any action taken by the Investors, in order that the Investors may have the opportunity, if they wish, of making certain that the

contract with the Company concerning matters of Investment Advising and Principal Underwriting will continue in force, in practical effect, without interruption.

No changes are contemplated in the management of the Company, except that, as stated, Mr. Leach will become Chairman of the Board, and Mr. Leland M. Kaiser will become President, and except that, if the proposal is approved to establish a Board of Directors for the Trust, the Company will, in its relations with the Trust, be subject to the control, supervision and direction of such Board. The investment policies of the Company now set forth in its registration statement and prospectus will continue unchanged, except to the extent that the proposed changes set forth in this Proxy Statement are authorized by the Investors. The facilities and personnel for supervision, research and analysis of investment securities will continue to be maintained as at present without any material change, except such changes as may be designed to improve and amplify the services.

Information With Respect to Officers and Directors
of Insurance Securities Incorporated

Name of Director	Principal Occupation or Employment	Year First Became Director	Beneficial Ownership Trust Fund ¹ Invest. Units	%	June 30, 1956 Company Sh.	%
*Howard Ainsworth	Director, Manufacturer	1955	28,734.905	.03	None	
*John J. Allen, Jr.	Director, Member Congress of U. S., Attorney at Law	1954	None		None	
*William H. Bowen	Director, Vice-President, Investments Management Corporation	1956	1,100.175	—	None	
Ossian E. Carr	Director, Vice-President, Treasurer, Insurance Securities Incorporated	1939	108,940.912	.12	17,000	10.2
Roy A. Haight	Director, Secretary, Accountant, Insurance Securities Incorporated	1938	94,329.694	.10	17,000	10.2
Leland M. Kaiser	Director, Vice-President, Insurance Securities Incorporated, Investment Banker	1956	1,039.242	—	14,000 ²	8.4
Abe P. Leach	Director, President, Counsel, Insurance Securities Incorporated	1938	51,866.785	.06	17,000	10.2
*E. R. Leach	Director, Mining Engineer	1942	70,619.267	.08	None	

Name of Director	Principal Occupation or Employment	Year First Became Director	Beneficial Ownership Trust Fund ¹		June 30, 1956 Company	
			Invest. Units	%	Sh.	%
A. J. Lonergan	Director, Vice-President, Agent, Insurance Securities Incorporated	1938	155,673.436	.16	17,000	10.2
*Elwood Murphey	Director, Attorney at Law	1946	7,127.846	.01	None	
Donald B. Rice	Director, Vice-President, Insurance Securities Incorporated	1942	17,684.304	.02	1,000	.6
*Brayton Wilbur	Director, Importer and Exporter	1955	1,456.250	—	None	
*A. J. Woolsey	Director, Superior Judge, State of California	1942	10,788.636	.01	None	

*The members whose names are preceded by an asterisk, and constituting a majority of the Board, are not affiliated persons of Insurance Securities Incorporated as defined in the Investment Company Act of 1940, except as Directors.

¹The stockholders of Insurance Securities Incorporated have a beneficial ownership in the Trust Fund through participating agreements of \$233,000.00, representing 144,633.058 investment units or .15% standing in the name of Insurance Securities Incorporated. Elwood Murphey, as a partner in the law firm of Wells, Murphey and Coffey, participated in legal fees paid said firm of \$6,125.00. Ossian E. Carr received \$7,348.72 and Arthur J. Lonergan received \$55,017.79 from the General Sales Agent for Insurance Securities Incorporated in payment of commissions upon sales made by them.

²See "Stockholdings in the Company" herein.

Mr. William H. Bowen was elected a director of the Company on February 24, 1956. He is a Vice President and a Director of Investments Management Corporation, Dallas, Texas. He is also a Director of the Indianapolis Water Company, Indianapolis, Indiana, and of Diebold, Inc., Canton, Ohio. Prior to joining Investments Management Corporation in 1953, he was a practicing attorney and had been a partner in the Chicago law firm of Chapman & Cutler, and the Dallas law firm of Jenkins & Bowen.

Mr. Leland M. Kaiser was elected a director February 24, 1956, and Vice-President February 28, 1956. He is senior partner of the investment banking firm of Kaiser & Co., San Francisco. He is also a Director of American Mail Line, Ltd., a Managing Partner of Tomahawk Oil and Gas Company. He is also a Director of California Taxpayers' Association, Trustee and Treasurer of World Trade Center, Inc., Trustee and Member of the Executive Committee of the San Francisco Bay Area Council. Previously, he served three years as Director of the San Francisco Chamber of Commerce and three years as Director of the San Francisco Community Chest.

No person has acted as an officer who was not a Director of the Company, except the Assistant Secretaries, who, by the Bylaws, are not required to be Directors.

All remuneration was paid in cash and no person who was a director or officer of Insurance Securi-

ties Incorporated at any time during the fiscal year ending December 31, 1955, received direct aggregate remuneration in excess of \$30,000.00, except as shown below:

Name	Capacities in Which Remuneration Was Received	Direct Aggregate Remuneration
Ossian E. Carr	Vice-President and Treasurer, Member of Executive Committee, Director and Investment Analyst	\$41,124.3
Roy A. Haight	Secretary, Member of Executive Committee, Director and Accountant	43,597.5
Abe P. Leach	President, Member of Executive Committee, Director and Legal Counsel	41,801.8
Arthur J. Lonergan	Vice-President, Member of Executive Committee and Director	41,124.3

The following persons, as a group, received the amount specified and no more:

(A) Identity of Group	(B) Capacities in Which Remuneration Was Received	(C) Direct Aggregate Remuneration
Officers and Directors	Officers and Directors	\$208,640.62

The Company has no bonus, profit sharing, or other remunerative plan and no pension or retirement plan or similar arrangement.

No part of said sums so received by said officers and directors were received directly from the Trust Fund, all of said sums being paid by Insurance Securities Incorporated out of the fees received. The only compensation paid by the Trust Fund to Insurance Securities Incorporated as Manager and Principal Underwriter of the Trust Fund was as follows: Administration Fees, \$348,303; Investment Supervision and Management Fees, \$211,972; Privi-

lege Fees, \$1,362; and Gross Creation Fees or Sales Load, \$5,548,964, out of which sum all new business acquisition expenses were paid including Gross Sales Commissions of \$4,220,331.

No officer or director of Insurance Securities Incorporated or any person who was a nominee for election as a director was indebted to said Insurance Securities Incorporated or to said Issuer in any sum or amount or at all since the beginning of the last fiscal year of said Issuer, except insofar as an indebtedness may have been incurred in the ordinary course of business.

Since the beginning of the last fiscal year of the Issuer no person who was a director or officer of Insurance Securities Incorporated during such period, or who was a nominee for election as a director thereof, received remuneration directly or indirectly from said Insurance Securities Incorporated or from said Issuer in the form of securities, options, warrants, rights or other property or through the exercise or disposition thereof.

Except as described herein, no director or officer of said Insurance Securities Incorporated or any associate of any such director, officer, or nominee has had any material interest, direct or indirect, in any significant transactions or transaction since the beginning of the last fiscal year of the Issuer, or in any significant proposed transactions or transaction, to which the Issuer and any one or more of such persons were or are to be parties or in any

transactions or transaction which involved or which is to involve the purchase or sale of property by or to the Issuer otherwise than in the ordinary course of business.

That said Issuer has no subsidiary or any affiliate other than Insurance Securities Incorporated which is the Manager and Investment Advisor of Issuer. Pacific National Bank of San Francisco, a National Banking association, as sole Trustee of said Issuer, received as aggregate remuneration as such Trustee, after deducting the amount allowed the Company for performing administrative duties, the sum of \$188,939 for said fiscal year.

Stockholdings in the Company

Messrs. Leach, Carr, Lonergan and Haight, Directors of the Company, each owned, as of June 30, 1956, 17,000 shares or 10.2% of the shares of the Company. Three of the other old stockholders held, in the aggregate, an additional 26,000 shares or 15.7%.

Mr. Kaiser, who is also a Director of the Company, has a 63.25% interest in Kaiser & Co., a limited partnership. Kaiser & Co. has acquired a beneficial ownership in an aggregate of 8,400 shares of the Company, 4,200 of which are held of record in the name of Mr. D. D. Harrington of Amarillo, Texas, and 2,200 in the name of Mr. S. W. Richardson and 2,000 in the name of Mr. Perry R. Bass, both of Fort Worth, Texas. In addition, Kaiser & Co. is a stockholder of Latmarco Incorporated,

and has a beneficial ownership in 6,000 shares of the Company held by Latmarco Incorporated. On the sale by Mr. Leach of substantially all of his holdings in the Company, referred to elsewhere herein, Kaiser & Co. expects to acquire a beneficial interest in an additional 3,200 shares which will be held of record in the name of Mr. D. D. Harrington. Kaiser & Co. will thus have a beneficial interest in a total of 17,600 shares or 10.6% of the Company.

Life Companies, Inc., owns all of the outstanding stock of Lamar Life Insurance Company and Atlantic Life Insurance Company, each of which, like Latmarco, hold 10,000 shares of the Company. Life Companies, Inc., is also a 40% stockholder of Latmarco Incorporated, and thus has a beneficial interest in a total of 24,000 shares or 14.5% of the Company, not including the 6,000 shares held by Latmarco Incorporated in which Kaiser & Co. has a beneficial interest.

Mr. D. D. Harrington has a beneficial interest in 16,800 shares or 10.1% of the Company, registered in his name, not including a contingent interest in 4,200 shares in which Kaiser & Co. has a beneficial interest. On the sale by Mr. Leach of substantially all of his holdings in the Company, referred to elsewhere herein, Mr. Harrington expects to acquire a beneficial interest in an additional 12,800 shares registered in his name. Mr. Harrington will thus have a beneficial interest in a total of 29,600 shares or 17.8% of the Company.

The Pacific National Bank of San Francisco has approved the proposed Supplemental Trust Agreement effecting the Amendments.

The enclosed Proxy, you will notice, provides for a vote "for" or "against" the adoption of said Supplemental Agreement and the adoption of the Amendments set forth therein. We trust you will indicate your approval in order that the purposes hereinabove may be accomplished. Remember that you must not only sign but also date the Proxy.

The beneficial units represented by said Proxy will be voted in accordance with the specifications. To become effective, each proposed amendment must be authorized by the holders of a majority of the investment units of the outstanding Participating Agreements, and Investors holding at least 25% of the total face amount of all Participating Agreements issued and outstanding at the time of mailing of notice of such proposed amendments must not, within sixty (60) days after the mailing of said notice, i.e., September 15, 1956, have delivered to Company written notice of dissent to such proposed amendment. If such proposed amendments become effective, they shall become binding upon each of the Investors, and dissenting Investors may surrender and terminate their Participating Agreements as provided therein or continue to hold the same under the Trust Agreement as so amended.

The Securities and Exchange Commission does not pass on the merits of any proposal submitted to Investors.

Dated: July 17, 1956, Oakland, California.

INSURANCE SECURITIES
INCORPORATED,

By R. A. HAIGHT,
Secretary.

Insurance Securities Incorporated
Oakland, California

Notice of Meeting of Investors

in a Trust Fund established under an Amended Trust Agreement dated December 18, 1939, as amended and supplemented, between Insurance Securities Incorporated, Pacific National Bank of San Francisco and Investors.

A meeting of Investors as aforesaid is hereby called by the Board of Directors of Insurance Securities Incorporated and by Pacific National Bank of San Francisco, as Trustee, to be held at The Bowl, Hotel Leamington, 19th and Franklin Streets, Oakland, California, on August 15, 1956, at 10:00 o'clock a.m. Pacific Daylight Saving Time, to consider and act upon proposals to amend the Amended Trust Agreement, as amended and supplemented.

1. To provide a board of trustees, to be known as the Board of Directors, to supervise the management of the business and affairs of the Trust;

2. To enlarge the list of Eligible Companies;
3. To change provision relating to designation of a Beneficiary;
4. To change provision relating to the Assignment of a Participating Agreement;
5. To reinstate the Investment Advisory contract with Insurance Securities Incorporated; and
6. To reinstate the Principal Underwriting contract with Insurance Securities Incorporated;

and to consider and act upon any other matters which may properly come before the meeting or any adjournment thereof.

Investors are urged to sign, date and return the enclosed Proxy immediately.

Dated: July 17, 1956.

INSURANCE SECURITIES
INCORPORATED,

R. A. HAIGHT,
Secretary.

PACIFIC NATIONAL BANK
OF SAN FRANCISCO,
As Trustee.

J. B. CHAMBERLAIN,
Trust Officer.

Proxy

The undersigned, holder of one or more Participating Agreements under the Amended Trust Agreement, hereby acknowledges receipt of a Notice of Meeting of Investors, of a Notice of Proposed Supplemental Agreement and of a Proxy Statement relating to approval of the proposed amendments to the Amended Trust Agreement and hereby constitutes and appoints Abe P. Leach, Leland M. Kaiser and R. A. Haight, Attorneys and Proxies for and on behalf of the undersigned to act and vote at a meeting of Investors to be held at The Bowl, Hotel Leamington, 19th and Franklin Streets, Oakland, California, on August 15, 1956, and at any adjournment or adjournments thereof in connection with (1) the proposals referred to below and (2) any other business which may be brought before such meeting or any adjournment thereof, according to the number of votes and as fully as the undersigned would be entitled to act and vote if personally present.

A majority of said Attorneys and Proxies who shall be present and acting as such at said meeting or any adjournment thereof, or if only one such Attorney and Proxy be present and acting then that one, shall have and may exercise all the powers hereby conferred.

Said Attorneys and Proxies are directed to vote as follows upon the following proposals more fully described in the Proxy Statement:

	For	Against
1. A proposal to provide a Board of Directors to supervise the management of the Trust.....	<input type="checkbox"/>	<input type="checkbox"/>
2. A proposal to enlarge the list of Eligible Companies.....	<input type="checkbox"/>	<input type="checkbox"/>
3. A proposal to change provision relating to designation of Beneficiary	<input type="checkbox"/>	<input type="checkbox"/>
4. A proposal to change provision relating to assignment of Participating Agreement.....	<input type="checkbox"/>	<input type="checkbox"/>
5. A proposal to reinstate contract as Investment Adviser.....	<input type="checkbox"/>	<input type="checkbox"/>
6. A proposal to reinstate contract as Principal Underwriter.....	<input type="checkbox"/>	<input type="checkbox"/>

Please Mark, Date, Sign and Mail at Once in Return Envelope. No Postage Required.

The Company Favors a Vote for Each of the Above Proposals

This Proxy shall be voted as directed or, where no direction is indicated, shall be voted For the proposal.

This Proxy shall be deemed to cover all Participating Agreements owned by me (us) in the Trust Fund.

Dated, 1956

Signature

Signature

Executors, Administrators, Trustees, Attorneys,
etc., should so indicate when signing.

This Proxy is solicited on behalf of the Management.

[Stamped]: Received July 16, 1956, U.S.S.E.C.

Duly verified.

[Endorsed]: Filed August 13, 1956.

[Title of District Court and Cause.]

AMENDMENT TO COMPLAINT

The Securities and Exchange Commission, plaintiff herein, amends its complaint in the following respects:

1. Page 1, line 25, strike the first five words and in lieu thereof substitute the following: "It appearing that Insurance Securities Incorporated and the."

2. Page 7, line 27, insert after the words "director-defendants" the words "and Insurance Securities."

3. Add to page 9, paragraph 31, the following:

"It also omits to state the net asset or net book value, per share, of the stock of Insurance Securities. It also omits to state the aggregate profit the director-defendants have obtained or will obtain from the sale of their stock of Insurance Securities."

4. Add to page 9, paragraph (1) of the relief sought the following: "and permanently enjoining

Insurance Securities Incorporated from acting as investment adviser and principal underwriter of the Trust Fund.”

Dated: August 13, 1956.

/s/ THOMAS G. MEEKER,
General Counsel;

/s/ AARON LEVY,
Attorney, Securities and
Exchange Commission.

/s/ F. E. KENNAMER, JR.,
Attorney, Securities and
Exchange Commission.

Duly verified.

[Endorsed]: Filed August 13, 1956.

[Title of District Court and Cause.]

INTERLOCUTORY ORDER

This action came on for hearing this 14th day of August on the application of the Securities and Exchange Commission, plaintiff herein, for a preliminary injunction; and the defendants and each of them, other than the Trust Fund, through their counsel having tendered in open Court an Undertaking to refrain from voting proxies received from investors in the Trust Fund sponsored by defendant Insurance Securities Incorporated at the meeting of Investors scheduled for August 15, 1956, or

at any adjournment thereof, with respect to the following proposals:

(a) The proposed reinstatement of the Investment Advisory Contract between Insurance Securities Incorporated and the Trust Fund.

(b) The proposed reinstatement of the Principal Underwriting Contract between Insurance Securities Incorporated and the Trust Fund.

(c) The election of Abe P. Leach and Roy A. Haight as members of the board of directors of the Trust Fund.

pending further order of the Court; and the Court having approved said Undertaking;

It Is Ordered that the defendants comply with said Undertaking, and that subject to compliance therewith, the hearing on the plaintiff's application for a preliminary injunction is hereby continued to September 7, 1956, at 10:00 a.m.

It Is Further Ordered that the entry of the foregoing Interlocutory Order is without prejudice to any other relief to which the parties may be entitled.

Dated: August 14, 1956.

/s/ LOUIS E. GOODMAN,

United States District Judge.

The parties hereto stipulate to the entry of the foregoing Interlocutory Order.

SECURITIES AND
EXCHANGE COMMISSION,

By /s/ AARON LEVY,

/s/ F. E. KENNAMER, JR.,
Attorneys for Plaintiff.

/s/ PHILIP S. EHRLICH,

/s/ ALFRED JARETZKI, JR.,

/s/ ELWOOD MURPHEY,
Attorneys for Defendants
Other Than Trust Fund.

[Endorsed]: Filed August 14, 1956.

[Title of District Court and Cause.]

REQUEST FOR ADMISSION OF FACT

Pursuant to Rule 36 of the Rules of Civil Procedure defendants Insurance Securities Incorporated, Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight, and Leland M. Kaiser as attorney and proxy for investors of Trust Fund, request plaintiff to admit, within ten (10) days after service of this request, the truth of certain matters of fact, as follows:

1. That under date of August 13, 1956, the plaintiff Securities and Exchange Commission issued its so-called "Litigation Release No. 1007," which contained the following statement:

"In connection with the filing of the action, Chairman J. Sinclair Armstrong of the Commission issued the following statement:

" 'The investors in the Trust Fund, managed and sponsored by Insurance Securities, Inc., should not be injured in any way whatsoever by the action taken today by the Securities and Exchange Commission. The suit brought by the Commission is intended to assure to investors legal protection which the Commission believes was intended by the Congress in the Investment Company Act of 1940. We want to emphasize that the action does not concern the investments in insurance stocks nor the portfolio of the Trust Fund, nor the manner in which Insurance Securities, Inc., has managed the funds invested in Trust Fund.

" 'The complaint does not allege that the defendants have mismanaged or misappropriated any of the assets of the Trust Fund. The filing of the complaint is not intended to disturb the value of investments in the Trust Fund which as of December 31, 1955, totaled about \$215,000.000.' "

2. That it is not contended by plaintiff, and that no charge is made, that any defendant has misman-

aged or misappropriated any of the assets of the Trust Fund.

Dated: August 20, 1956.

/s/ MOSES LASKY,

BROBECK, PHLEGER &
HARRISON.

/s/ PHILIP S. EHRLICH,

/s/ ALFRED JARETZKI, JR.,
SULLIVAN & CROMWELL.

/s/ ELWOOD MURPHEY,

Attorneys for the Aforemen-
tioned Defendants.

Service of copy acknowledged.

[Endorsed]: Filed August 21, 1956.

[Title of District Court and Cause.]

NOTICE OF MOTION TO DISMISS
AND TO DISSOLVE

To: Plaintiff Securities and Exchange Commission,
and to Its Attorneys, Thomas G. Meeker, Esq.;
Aaron Levy, Esq., and Franklin E. Kennamer,
Esq.:

Please Take Notice, hereby given, that on Friday, September 7, 1956, at 10 o'clock a.m. or as soon thereafter as counsel can be heard, defendants In-

Insurance Securities Incorporated, Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight, and Leland M. Kaiser as attorney and proxy for investors of Trust Fund, will move the above-entitled court, before the Honorable Louis E. Goodman, in the court room at Seventh and Mission Streets, San Francisco, California, as follows:

1. To Dismiss the alleged first count or "first cause of action" of the complaint as against these defendants, and severally as against each of them, for failure to state a claim for relief.

2. To Dismiss the alleged second count or "second cause of action" of the complaint as against these defendants, and severally as against each of them, for failure to state a claim for relief.

3. To Dissolve the interlocutory order entered herein on or about August 14, 1956.

The motions to dismiss will be based on the complaint herein. The motions to dismiss will also be based upon the complaint and on all other pleadings and papers on file herein, including the affidavit of Jack I. Elias filed herein by plaintiff, and the affidavits filed herewith in opposition to the application for a preliminary injunction, to wit, the affidavits of Leland M. Kaiser, Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight, D. D. Harrington, John D. Murchison, S. W. Richardson, Perry R. Bass, and such other affidavits as may be filed on or before the hearing of the motions, as well as on all admissions made prior thereto.

The motion to dissolve will be based upon each and all the papers and data mentioned above, and will be made on the ground that the said interlocutory order was to remain in effect until the further order of the Court, and that no interlocutory injunction or restraint is warranted under the statute or in equity.

Dated: August 24, 1956.

/s/ MOSES LASKY,

BROBECK, PHLEGER &
HARRISON,

/s/ PHILIP S. EHRLICH,

/s/ ALFRED JARETZKI, JR.,

SULLIVAN & CROMWELL,

/s/ ELWOOD MURPHEY,

Attorneys for Above-Named
Defendants.

Due service and receipt of a copy of the within is hereby admitted this 24th day of Aug., 1956.

/s/ F. E. KENNAMER,

Attorney for Plaintiff.

[Title of District Court and Cause.]

**AFFIDAVIT OF LELAND M. KAISER
ON BEHALF OF DEFENDANTS**

State of California,
City and County of San Francisco—ss.

Leland M. Kaiser, being first duly sworn, deposes and says:

I am a director and the president of Insurance Securities Incorporated, hereafter called ISI. At all times herein mentioned, I have been and am now a general partner in the co-partnership known as Kaiser & Co., investment bankers of San Francisco, California.

I have read the complaint herein and note paragraph 18 thereof, which reads as follows:

“18. During the same period, the director-defendants sold to the purchasers the following number of shares:

Leach	29,000 shares
Carr	13,000 shares
Lonergan	13,000 shares
Haight	13,000 shares

By reason of the aforesaid transfers, the director-defendants reduced their stock interests in Insurance Securities from 72% to 31.2%. The amount thus transferred to the purchasing group amounted to about 40.8% of the total outstanding. The balance of approximately

13% were purchased from the other individual holders except Rice.”

Among the erroneous allegations in this passage is the allegation of a “purchasing group.” There is not and never was a “purchasing group” that purchased the stock in question. The facts are as follows.

Some time prior to the year 1956 my attention was drawn to ISI, particularly by the fact that the President of ISI, Mr. Abe P. Leach, was then over 80 years of age. It occurred to me that in due course of events stock of ISI would come onto the market. As an investment banker, it is part of my profession and occupation to find buyers for securities seeking buyers, and to find opportunities for capital seeking investment. I therefore approached Mr. Leach. He first stated that he was not interested in selling, but on a later approach he stated that, while he was interested, he would sell none of his stock unless an opportunity were given to other stockholders to sell theirs. I talked to Messrs. Ossian E. Carr, Arthur J. Lonergan and Roy A. Haight, who were stockholders.

Meanwhile I interested Mr. D. D. Harrington of Amarillo, Texas, and John D. Murchison of Dallas, Texas, president of Life Companies, Inc., in ISI stock. In February, 1956, I obtained separate options from each of the following stockholders of ISI, to wit: Messrs. Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight and E. Smith, each of whom granted to Kaiser & Co. or to such

person or persons as I might interest the right to buy 8,000 shares of ISI stock. (At that time it was 8 shares each, but subsequently the stock was split 1,000 for 1. This affidavit will follow the complaint in referring to the stock by its post split-up equivalents.)

Mr. D. D. Harrington then bought 10,000 shares, and Mr. John D. Murchison, the President of Life Companies, Incorporated (hereafter called Life), caused subsidiaries of Life to buy a total of 30,000 shares. The several sales were consummated in February, 1956. 10,000 shares were transferred to Atlantic Life Insurance Co. and 10,000 shares to Lamar Life Insurance Co., each of which is a subsidiary of Life. 10,000 shares were transferred to Latmarco Incorporated, of which Life owns all the voting stock. And 10,000 shares were transferred to D. D. Harrington. Atlantic, Lamar and Latmarco may be said to be a group since they are affiliated through Life and hereafter in this affidavit will be referred to as the "Life group." But D. D. Harrington was and is no part of the Life group and the sales to the two were separately arranged and had no connection with each other.

In May, 1956, I interested D. D. Harrington in the idea of purchasing more ISI stock if it could be obtained. Independently and wholly unrelated to Mr. Harrington, I interested Richardson & Bass of Fort Worth, Texas, in buying ISI stock. I then approached the following stockholders of ISI and obtained from them options to buy running to

Kaiser & Co. or such person or persons as I might interest covering the following number of shares:

Abe P. Leach	5,000 shares
Ossian E. Carr	5,000 shares
Arthur J. Lonergan	5,000 shares
Roy A. Haight	5,000 shares
Elwood E. Smith	3,000 shares
Mrs. Hazel Plant	5,000 shares
Barbara I. McConnell	2,000 shares
Walter E. Smith	2,000 shares

In due course, in May, 1956, sales of this aggregate quantity of stock were effected as follows: 11,000 shares, consisting of 3,000 shares belonging to Elwood Smith, 4,000 shares belonging to Mrs. Hazel Plant, 2,000 shares belonging to Barbara I. McConnell, and 2,000 shares belonging to Walter E. Smith, were sold and transferred to D. D. Harrington. None of these sellers was or is a director of ISI.

The 20,000 shares coming from Leach, Carr, Lonergan and Haight, plus 1,000 shares sold by Mrs. Plant, were sold and transferred to Richardson & Bass. Thus, four persons made sales to Mr. Harrington and five persons made sales to Richardson & Bass. The four sales to Mr. Harrington were wholly separate from the five sales to Richardson & Bass. The several sales were separately arranged, had no connection with each other, and there was no understanding obtained or arranged by me among them.

Shortly afterwards the partnership of Richardson & Bass transferred 11,000 of the shares obtained by it to S. W. Richardson, and 10,000 shares to Perry R. Bass.

Still later I approached Mr. Leach again in view of the fact that he was rapidly approaching his eighty-third birthday and there was talk of his retirement from active management. Mr. Leach was persuaded and in July, 1956, entered into an agreement with Kaiser & Co. for the sale of 16,000 shares of stock to Kaiser & Co. or someone I should interest. A copy of the agreement is attached to an affidavit of Mr. Leach filed concurrently herewith. In turn, I interested Mr. D. D. Harrington in buying the 16,000 shares and he has agreed to do so upon the terms expressed in such agreement.

There was and is not to my knowledge any affiliation or relationship between the Life group or any stockholder thereof or interest therein, on the one hand, and either D. D. Harrington, S. W. Richardson or Perry R. Bass, on the other.

In consideration of my services as a partner in Kaiser & Co., acting in the capacity of investment bankers in bringing together the several distinct buyers and sellers, as stated above, I obtained distinct and separate agreements with (a) Mr. D. D. Harrington, (b) Mr. S. W. Richardson, and (c) Mr. Perry R. Bass, whereby each has given Kaiser & Co. an interest in 20% of their respective shares in ISI and the exclusive right to vote the number

of shares equal to 20% of the total transferred to each one, respectively. And by virtue of an agreement with Mr. D. D. Harrington, Kaiser & Co. will obtain the exclusive right to vote 3200 shares (20% of 16,000) when the last sale is consummated.

In consideration of the services rendered by Kaiser & Co. as investment bankers in the sale to the Life group, Kaiser & Co. obtained by agreement with Latmarco the exclusive right to vote 6,000 shares of stock owned by Latmarco (Kaiser & Co. owns 60% of the capital stock of Latmarco).

Neither Kaiser & Co., nor any partner of Kaiser & Co., has any understanding, arrangement or contract, other than those mentioned specifically above, with Life or any affiliate of Life, or with S. W. Richardson, D. D. Harrington, or Perry R. Bass, or with anyone else who owns any stock of ISI or possesses any beneficial interest therein concerning ISI stock or the voting thereof, or any purchase or sale thereof to be made hereafter. And none is affiliated with any one in respect to ISI stock, or part of any group owning or possessing any ISI stock or beneficial interest therein.

As a consequence of the various sales referred to above, namely, the sales to the Life group in February, 1956, the sales to D. D. Harrington in February, 1956, the sales to D. D. Harrington in May, 1956, the sales to Richardson & Bass in May, 1956, and the subsequent transfer to S. W. Richardson and Perry R. Bass, and the contract of sale of July,

1956, to D. D. Harrington, and as a consequence of the several agreements between the respective purchasers and Kaiser & Co., the following situation now exists:

Name		No. of Shares	% of ISI Shares Outstand- ing
Life Group	has become the absolute owner of and entitled to vote.....	24,000	14.5%
D. Harrington	upon consummation of the last sale, will have become the absolute owner of and entitled to vote of which more than $\frac{1}{3}$ will have been purchased from stockholders who were not directors of ISI and not defendants in this cause	29,600	or 17.8%
W. Richardson	has become the absolute owner of and entitled to vote.....	8,800	5.3%
Harry R. Bass	has become the absolute owner of and entitled to vote.....	8,000	4.8%
Kaiser & Co.	will have become the owner of a beneficial interest in and entitled to vote.....	17,600	10.6%

It will be seen that even after consummation of the last sale provided for in the contract of July, 1956, and even if the number of shares in which Kaiser & Co. has a beneficial interest were added to the holdings of the other purchasers, considerably less than 25% of the stock of ISI will have been sold to and transferred to any one purchaser.

Kaiser & Co. is free to exercise its own individual judgment with respect to voting any and all ISI

stock for which it has been given voting rights as stated above, and intends to do so at all times.

/s/ LELAND M. KAISER.

Subscribed and sworn to before me this 23rd day of August, 1956.

[Seal] /s/ MAUDE N. NASH,
Notary Public in and for the City and County of
San Francisco, State of California.

My Commission Expires October 14, 1958.

[Title of District Court and Cause.]

AFFIDAVIT OF ABE P. LEACH ON
BEHALF OF DEFENDANTS

State of California,
County of Alameda—ss.

Abe P. Leach, being first duly sworn, deposes and says:

I.

I am one of the named defendants in the above-entitled cause and a member of the State Bar of California. For many years prior to February, 1956, I was the owner of 30 shares of the capital stock of Insurance Securities Incorporated (hereafter called ISI), its President, chief executive officer and legal counsel. At that time the total num-

ber of shares outstanding of ISI was 166. In June, 1956, the stock was split so that 1,000 shares were substituted for each 1 share, and ever since the total number of shares outstanding has been 166,000. In this affidavit, with respect to times prior to the split as well as subsequent, the stock will be referred to in terms of its equivalents subsequent to June, 1956.

II.

My attention has been called to the allegation of paragraph 16 of the complaint reading as follows:

“Upon information and belief, on or about February 1, 1956, the director-defendants, either alone or in concert with others, embarked upon a plan to sell their stock interests to a small number of purchasers, affiliated among each other through stock ownership and otherwise.”

This allegation is untrue in several respects. First, it is not true if construed as alleging that I acted in concert with anyone else. Second, it is untrue in alleging that I embarked on a plan to sell my stock interest to any purchasers affiliated with or among each other in any manner or by any means. Third, it is untrue in alleging that I embarked on any plan with respect to my stock in February, 1956, or any other time.

The facts are these: Prior to February, 1956, Mr. Leland M. Kaiser, a general partner of Kaiser & Co., investment bankers of San Francisco, Cali-

foria, had approached me and inquired of me whether I was interested in selling my shares. I said to him that other stockholders of ISI must be given an equal opportunity to sell stock if they desired. In February, 1956, I gave a written option to Kaiser & Co. to buy 8,000 shares of my stock, and to assign to others the right to buy some or all of said shares. Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight and E. Smith were stockholders of ISI, and I understand that each gave to Kaiser & Co. an option covering 8,000 shares apiece. I was not acting in concert with said Carr, Lonergan, Haight and Smith, or with any of them, and regardless of whether they or any of them sold, I would have been willing to sell or to give an option to sell the 8,000 shares of mine covered by the agreement.

Thereafter, in February, and pursuant to the option, I transferred my said 8,000 shares simultaneously with the transfer of an aggregate of 32,000 shares by others, and 10,000 shares each were transferred to Atlantic Life Insurance Co., Lamar Life Insurance Co., Latmarco Incorporated, and D. D. Harrington.

Later, Leland M. Kaiser of Kaiser & Co. again approached me with respect to obtaining an option to purchase additional stock, and I gave Kaiser & Co. a similiar option to purchase 5,000 shares. In May, 1956, the 5,000 shares were transferred contemporaneously with transfers of an aggregate of 32,000 shares by eight stockholders of ISI, viz.,

Messrs. Carr, Lonergan, Haight, E. Smith, W. Smith, Miss McConnell and Mrs. Plant. I was not acting in concert with any of these people, and regardless of whether they or any of them sold, I would have been willing to sell or give an option to sell the 5,000 shares of mine covered by the agreement.

In selling said 8,000 shares of stock, and later the 5,000 shares, I knew nothing about the existence of any affiliation among transferees, if any existed. I did not embark upon a plan to sell to affiliated buyers.

In June, 1956, Mr. Kaiser asked me whether I was willing to sell additional stock. I came to the decision that, since I was approaching my eighty-third birthday, I should retire from active management, and therefore, I desired to dispose of substantially all the remainder of my stock in ISI, which at that time constituted 17,000 shares. As a consequence I entered into an agreement with Kaiser & Co., a true copy of which is attached as Exhibit 1. At that time no other stockholders of ISI, to my understanding or knowledge, entered into any agreements of option or sale to dispose of any of their stock, and I was not interested in whether other stockholders were or were not making sales.

None of the stock covered by said agreement (Exhibit 1) has yet been transferred. As the agreement states, it provides that transfer of the stock will be made and the sale consummated regardless of

whether or not the Amendment to the Trust Agreement constituting a new contract between the trustee and ISI concerning matters of investment advice and principal underwriting was approved by the investors. The agreement provides that the consummation of the sale and transfer will take place on the day when said Amendment to the Trust Agreement becomes effective, if it is adopted, and in the event it is not approved by the investors as required by the trust agreement and by law, then on the seventh day after rejection of the amendment by the investors. Neither event has occurred and no part of the said 17,000 shares has been transferred.

/s/ ABE P. LEACH.

Subscribed and sworn to before me this 22nd day of August, 1956.

[Seal] /s/ WM. S. WELLS, JR.,
Notary Public in and for the County of Alameda,
State of California.

EXHIBIT 1

This Agreement, made this 7th day of July, 1956, by and between Abe P. Leach (hereinafter called "Leach") and Kaiser & Co., a partnership formed under the laws of the State of California (hereinafter called "Kaiser"),

Witnesseth

1. Leach hereby agrees to sell to Kaiser and Kaiser agrees to purchase from Leach sixteen thousand (16,000) shares of the common capital stock of Insurance Securities Incorporated at a price of fifty dollars (\$50) per share.

2. Kaiser agrees that under no circumstances will it acquire for its own account more than twenty-four and three-fourths per cent ($24\frac{3}{4}\%$) of said sixteen thousand (16,000) shares, or of the total outstanding shares of Insurance Securities Incorporated, it being understood that this contract is being obtained by Kaiser for the purpose of affecting the distribution of more than seventy-five per cent (75%) of said sixteen thousand (16,000) shares to one or more other purchasers.

3. Kaiser agrees that any purchaser or purchasers to whom it may assign the right to purchase all or any part of said sixteen thousand (16,000) shares shall not, as a result of such purchase, hold individually a beneficial interest in, or a right to vote, more than twenty-four and three-fourths per cent ($24\frac{3}{4}\%$) of the voting shares of Insurance Securities Incorporated.

4. Leach agrees to make delivery of the certificate or certificates for said sixteen thousand (16,000) shares endorsed in blank and Kaiser agrees to make payment therefore on the same day as, but immediately prior to, the effective time of the Amendment to the Trust Agreement, constituting

a new contract between the Trustee and Insurance Securities Incorporated, concerning matters of Investment advising and principal underwriting, but if such amendment and contract be not approved as required by the Trust Agreement and by law, then upon the seventh (7th) day after its rejection by investors in the trust fund, and title to said shares shall vest in Kaiser at the time herein provided for delivery of said shares to Kaiser.

5. Leach agrees to pay the Federal stock transfer tax upon the sale of said sixteen thousand (16,000) shares.

6. This agreement shall be binding upon and shall inure to the benefit of the heirs, executors, administrators, successors and assigns of the respective parties hereto.

In Witness Whereof, the parties hereto have hereunto set their hands as of the date first above written.

.....,
ABE P. LEACH.

KAISER & CO.,

By

[Title of District Court and Cause.]

AFFIDAVIT OF OSSIAN E. CARR
ON BEHALF OF DEFENDANTS

State of California,
County of Alameda—ss.

Ossian E. Carr, being first duly sworn, deposes and says:

I am one of the named defendants in the above-entitled cause. For many years prior to February, 1956, I owned 30 shares (now 30,000 shares in view of subsequent split-up) of the capital stock of Insurance Securities Incorporated, hereafter called ISI. Hereafter in this affidavit the shares will be referred to in terms of their equivalents after the split-up.

I have read the sentence on page 16 of the complaint reading as follows:

“Upon information and belief, on or about February 1, 1956, the director-defendants, either alone or in concert with others, embarked upon a plan to sell their stock interests to a small number of purchasers, affiliated among each other through stock ownership and otherwise.”

This allegation is untrue (1) so far as it may be deemed to allege that I acted in concert with anyone else; (2) insofar as it alleges that I embarked on a plan to sell my stock interest to any purchasers affiliated with or among each other in any manner

or by any means; and (3) so far as it alleges that I embarked on any plan in February, 1956, or at any other time.

Prior to February, 1956, I was advised that Mr. Leland M. Kaiser, a general partner of Kaiser & Co., had approached Mr. Abe P. Leach, President of ISI and a stockholder, with respect to obtaining an option to purchase his stock. Subsequently, I granted my own option to Kaiser & Co. to purchase 8,000 shares of my stock or to assign the right to purchase to others, in whole or in part. I understand that Abe P. Leach, Arthur J. Lonergan, Roy A. Haight and E. Smith each also executed an option covering 8,000 shares. I was not acting in concert with said Leach, Lonergan, Haight and Smith, or with any of them, and would have been willing to sell or to give an option to sell my 8,000 shares covered by the agreement, whether or not any of the other persons above-named gave or was willing to give an option or to sell. Thereafter in February, and pursuant to the option, I transferred my said 8,000 shares.

Later, Mr. Kaiser approached me with respect to obtaining an option to purchase additional stock, and I gave Kaiser & Co. a similar option to purchase 5,000 shares. In May, 1956, the said 5,000 shares were transferred contemporaneously with transfers of an aggregate of 32,000 shares by eight stockholders of ISI.

In selling the 8,000 shares in February and again in selling the 5,000 shares in May, I knew nothing

about the existence of any affiliation among transferees, if there was any. I did not embark upon a plan to sell to affiliated buyers.

/s/ OSSIAN E. CARR.

Subscribed and sworn to before me this 22nd day of August, 1956.

[Seal] /s/ WM. S. WELLS, JR.

Notary Public in and for the County of Alameda,
State of California.

[Title of District Court and Cause.]

**AFFIDAVIT OF ARTHUR J. LONERGAN
ON BEHALF OF DEFENDANTS**

State of California,
County of Alameda—ss.

Arthur J. Lonergan, being first duly sworn, deposes and says:

I am one of the named defendants in the above-entitled cause. For many years prior to February, 1956, I owned 30 shares (now 30,000 shares in view of subsequent split-up) of the capital stock of Insurance Securities Incorporated, hereafter called ISI. Hereafter in this affidavit the shares will be referred to in terms of their equivalents after the split-up.

I have read the sentence on page 16 of the complaint reading as follows:

“Upon information and belief, on or about February 1, 1956, the director-defendants, either alone or in concert with others, embarked upon a plan to sell their stock interests to a small number of purchasers, affiliated among each other through stock ownership and otherwise.”

This allegation is untrue (1) so far as it may be deemed to allege that I acted in concert with anyone else; (2) insofar as it alleges that I embarked on a plan to sell my stock interest to any purchasers affiliated with or among each other in any manner or by any means; and (3) so far as it alleges that I embarked on any plan in February, 1956, or at any other time.

Prior to February, 1956, I was advised that Mr. Leland M. Kaiser, a general partner of Kaiser & Co., had approached Mr. Abe P. Leach, President of ISI and a stockholder, with respect to obtaining an option to purchase his stock. Subsequently, I granted my own option to Kaiser & Co. to purchase 8,000 shares of my stock or to assign the right to purchase to others, in whole or in part. I understand that Abe P. Leach, Ossian E. Carr, Roy A. Haight and E. Smith each also executed an option covering 8,000 shares. I was not acting in concert with said Leach, Carr, Haight and Smith, or with any of them, and would have been willing to sell or to give an option to sell my 8,000 shares covered

by the agreement, whether or not any of the other persons above-named gave or was willing to give an option or to sell. Thereafter in February, and pursuant to the option, I transferred my said 8,000 shares.

Later, Mr. Kaiser approached me with respect to obtaining an option to purchase additional stock, and I gave Kaiser & Co. a similar option to purchase 5,000 shares. In May, 1956, the said 5,000 shares were transferred contemporaneously with transfers of an aggregate of 32,000 shares by eight stockholders of ISI.

In selling the 8,000 shares in February and again in selling the 5,000 shares in May, I knew nothing about the existence of any affiliation among transferees, if there was any. I did not embark upon a plan to sell to affiliated buyers.

/s/ ARTHUR J. LONERGAN.

Subscribed and sworn to before me this 22nd day of August, 1956.

[Seal] /s/ WM. S. WELLS, JR.,
Notary Public in and for the County of Alameda,
State of California.

[Title of District Court and Cause.]

AFFIDAVIT OF ROY A. HAIGHT
ON BEHALF OF DEFENDANTS

State of California,
County of Alameda—ss.

Roy A. Haight, being first duly sworn, deposes and says:

I.

I am one of the named defendants in the above-entitled cause, and I am now and at all times mentioned have been the Secretary of Insurance Securities Incorporated, hereafter called ISI. For many years prior to February, 1956, I owned 30 shares (now 30,000 shares in view of subsequent split-up) of the capital stock of ISI. Hereafter in this affidavit the shares will be referred to in terms of their equivalents after the split-up.

II.

I have read the sentence on page 16 of the complaint reading as follows:

“Upon information and belief, on or about February 1, 1956, the director-defendants, either alone or in concert with others, embarked upon a plan to sell their stock interests to a small number of purchasers, affiliated among each other through stock ownership and otherwise.”

This allegation is untrue, (1) so far as it may be deemed to allege that I acted in concert with any-

one else; (2) insofar as it alleges that I embarked on a plan to sell my stock interest to any purchasers affiliated with or among each other in any manner or by any means, and (3) so far as it alleges that I embarked on any plan in February, 1956, or at any other time.

Prior to February, 1956, I was advised that Mr. Leland M. Kaiser, a general partner of Kaiser & Co., had approached Mr. Abe P. Leach, President of ISI and a stockholder, with respect to obtaining an option to purchase his stock. Subsequently, I granted my own option to Kaiser & Co. to purchase 8,000 shares of my stock or to assign the right to purchase to others in whole or in part. I understand that Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan and E. Smith each also executed an option covering 8,000 shares. I was not acting in concert with said Leach, Carr, Lonergan and Smith, or with any of them, and would have been willing to sell or to give an option to sell my 8,000 shares covered by the agreement, whether or not any of the other persons above-named gave or was willing to give an option or to sell. Therafter, in February, and pursuant to the option, I transferred my said 8,000 shares.

Later, Mr. Kaiser approached me with respect to obtaining an option to purchase additional stock, and I gave Kaiser & Co. a similar option to purchase 5,000 shares. In May, 1956, the said 5,000 shares were transferred contemporaneously with

transfers of an aggregate of 32,000 shares by eight stockholders of ISI.

In selling the 8,000 shares in February, and again in selling the 5,000 shares in May, I knew nothing about the existence of any affiliation among transferees, if any existed. I did not embark upon a plan to sell to affiliated buyers.

III.

I have read the Affidavit of Jack I. Elias filed by plaintiff herein. It is true, as there stated, that I received the letter from the Division of Corporate Finance, Securities and Exchange Commission, dated July 10, 1956, a copy of which is attached to Mr. Elias' affidavit as Exhibit I. All the suggestions for change and revision in the proxy solicitation material were duly made, and the proxy solicitation material as sent to the investors embodied all such changes. Never, by letter or otherwise, did anyone in the Securities and Exchange Commission suggest or request any further or different changes or revisions or intimate that any should be made.

The said letter of July 10, 1956, from the Division of Corporate Finance contains the sentence:

“We understand that our Division of Corporate Regulation has raised certain questions regarding the assignment of the Investing, Advising and Underwriting Contracts.”

But never orally or in any other manner did anyone in the Securities and Exchange Commission suggest

or request any insertion or change in the proxy solicitation material referring to or relating to that fact.

After receipt of the letter on July 12, 1956, I was in communication with the attorney under whose supervision the proxy material was prepared, Alfred Jaretzki, Jr., Esq., of the law firm of Sullivan & Cromwell in New York City, discussed the letter with him and thereafter followed his legal advice on what was required.

It is also true, as stated in Mr. Elias' affidavit, that on or about July 13, 1956, to wit July 12, 1956, he telephoned to me. Mr. Elias referred to Section 36 of the Investment Company Act of 1940, but he did not say, suggest or intimate that additions or revisions should be made in the proxy solicitation material as a consequence of or related to Section 36. Mr. Elias merely asked for the information mentioned in his affidavit, and all material requested by him was in fact sent to him by Mr. Jaretzki. I asked Mr. Elias whether I was free to mail the proxy solicitation material or whether there was anything in the telephone call which affected my doing so. Mr. Elias did not at any time state, suggest or intimate that, in order to avoid a charge of being false or misleading, the proxy solicitation material should contain any reference to the so-called Section 36 problem or the facts connected therewith.

IV.

As secretary of the ISI, I know the provisions of the Amended Trust Agreement, last amended as

of October 1, 1954, which is the instrument referred to in paragraph 5 and elsewhere in the complaint herein. Article XI of said agreement contains the following provisions:

“Section 1.

Amendments Authorized.

Company may at any time propose amendments to this Trust Agreement by adoption of a resolution by its Board of Directors proposing such amendments, provided that such amendments, if adopted, shall not in anywise affect the amount of the monthly payments to be made on Participating Agreements then issued and outstanding, or the property held in Trust with respect to any such Participating Agreement, or shall not give any Participating Agreements any preference or priority over other Participating Agreements then issued and outstanding with respect to any funds or property held by Trustee in Trust.

Section 2.

Amendments, How Effected.

A supplemental Trust Agreement incorporating such proposed amendments shall be prepared by Company and submitted to Trustee for its approval. Upon approval thereof by Trustee and by any officer or body whose approval thereof may be required by law, Company shall mail a notice embodying such proposed supplemental Trust Agreement to each Investor. In the event that Investors holding

at least twenty-five (25%) per cent of the total face amount of all Participating Agreements issued and outstanding at the time of mailing of such notice shall not have delivered to Company within sixty (60) days after the mailing of such notice written dissent in respect of such proposed supplemental Trust Agreement, the Board of Directors of Company shall, within ten (10) days thereafter adopt a further resolution declaring that such proposed supplemental Trust Agreement has thereupon become effective. Company shall thereupon file with Trustee a copy of such resolution duly certified by the Secretary or Assistant Secretary of Company under its corporate seal. Company and Trustee shall execute such supplemental Trust Agreement by their officers thereunto duly authorized and under their corporate seals.

Such supplemental Trust Agreement shall thereupon and thereafter be binding upon Trustee, Company and each and every one of the Investors and the covenants and provisions contained therein shall be deemed to be part of this Trust Agreement.”

V.

My attention has been called to the allegation of paragraph 22 of the complaint reading as follows:

“Upon information and belief, in further pursuit of their unlawful conduct, the directors of Insurance Securities, including the director-

defendants, commenced solicitation for proxies for a meeting of investors of the Trust Fund.”

The fact is that the resolutions to amend the Amended Trust Agreement in the respects set forth in proposals submitted to the investors and described in the proxy solicitation material were adopted at the meeting of the Board of Directors of ISI held June 26, 1956, attended by the four defendant-directors and eight other directors and that, as stated in my official minutes as Secretary of ISI, the resolutions were moved and seconded by nonstockholder directors and “were adopted by the unanimous affirmative vote of those members of the Board who are not stockholders of the Company, the remaining directors not voting.” In my capacity as Secretary of ISI, I have acted in a ministerial manner in sending out the proxy solicitation material. Apart from this clerical act, the director-defendants have not engaged in solicitation of proxies.

/s/ ROY A. HAIGHT.

Subscribed and sworn to before me this 22nd day of August, 1956.

[Seal] /s/ WM. S. WELLS, JR.,
Notary Public in and for the County of Alameda,
State of California.

[Title of District Court and Cause.]

AFFIDAVIT OF D. D. HARRINGTON
ON BEHALF OF DEFENDANTS

State of California,
County of Orange—ss.

D. D. Harrington, being first duly sworn, deposes and says:

I am a resident of Amarillo, Texas, and my principal occupation is that of oil and gas producer and investments.

In the month of February, 1956, I purchased 10 shares (now 10,000 shares in view of subsequent split-up) of the capital stock of Insurance Securities, Incorporated, hereafter called "ISI." The transaction was handled through Kaiser & Co., investment bankers of San Francisco, California. Subsequently Kaiser & Co. advised me that it had obtained an option whereby I could purchase additional shares, and in May, 1956, I purchased 11,000 shares more.

In consideration of the fact that the two opportunities to purchase were brought to me by Kaiser & Co., agreements were entered into, on each occasion, between me and Kaiser & Co., whereby Kaiser & Co. received an interest in the proceeds of 20% of said stock and possesses the absolute right to vote 4 shares of ISI stock (now 4,000) as it sees fit but no voting rights with respect to the rest of the shares.

In July, 1956, I agreed with said Kaiser & Co. to purchase an additional 16,000 shares of ISI from Abe P. Leach. This transaction has not yet been consummated. In connection therewith I have an agreement with Kaiser & Co., similar to the one described above, whereby Kaiser & Co. will have a 20% interest in said stock and will be entitled to vote 20% of said shares, when acquired, as it sees fit.

I do not have any understanding, arrangement or contract with Kaiser & Co., Leland M. Kaiser or with anyone else who owns any ISI stock or possesses any beneficial interest therein, or anyone at all, concerning ISI stock or the voting thereof or any purchase and sale thereof to be made hereafter. I am not affiliated with anyone in respect of any ISI stock, and I am not part of any group owning or possessing any ISI stock or beneficial interest therein other than the relationship stated above with Kaiser & Co. I am free to exercise my own individual judgment with respect to voting my ISI stock or interest therein, and intend to do so at all times.

/s/ D. D. HARRINGTON.

Subscribed and sworn to before me this 21st day of August, 1956.

[Seal] /s/ MARGUERITE ERRECARTÉ,
Notary Public in and for the County of Orange,
State of California.

[Title of District Court and Cause.]

AFFIDAVIT OF JOHN D. MURCHISON
ON BEHALF OF DEFENDANTS

State of New Mexico,
County of Santa Fe—ss.

John D. Murchison, being first duly sworn, deposes and says: I am a resident of Dallas, Texas, and at all times herein mentioned have been and am the President of Life Companies, Incorporated, a Virginia corporation, hereafter called "Life." A majority of the capital stock of Life is owned by Murchison Bros., a partnership of which I am a general partner. Life is the owner of substantially all the capital stock of Atlantic Life Insurance Co., a Virginia corporation, hereafter called "Atlantic," and Lamar Life Insurance Co., a Mississippi corporation, hereafter called "Lamar." Life also owns all the voting stock of Latmarco, Incorporated, hereafter called "Latmarco." The voting stock of Latmarco constitutes 40% of its capitalization. The remaining 60% of Latmarco's capitalization is represented by non-voting stock owned by Kaiser & Co., Investment Bankers of San Francisco, California.

In February, 1956, in my capacity as Executive Officer of Life, I caused Atlantic, Lamar and Latmarco to buy 10 shares each of the capital stock of Insurance Securities Incorporated, hereafter called "ISI" (now 10,000 shares in view of split-up). The transaction was handled through said Investment Bankers, Kaiser & Co.

Neither Life, Atlantic, Lamar, Murchison Bros., nor any partner thereof, have any understanding, arrangement or contract with anyone else who owns any stock of ISI or possesses any beneficial interest therein concerning ISI stock or the voting thereof or the purchase and sale thereof. None is affiliated with anyone else in respect of any ISI stock or constitutes part of any group owning or possessing any ISI stock or beneficial interest therein other than the relationship shown above with Latmarco which arises by virtue of Life's ownership of Latmarco stock. Latmarco has an agreement with Kaiser & Co. whereby the latter is entitled to vote, as Kaiser & Co. sees fit, 60% of the ISI stock owned by Latmarco. Other than Latmarco's affiliation with Murchison Bros., Life, Atlantic and Lamar through Life, and other than the contractual relation mentioned above between Latmarco and Kaiser & Co., Latmarco has no understandings, arrangements, or contracts with anyone concerning said stock or anyone else, the voting thereof, or the purchase or sale thereof, and is not affiliated with anyone and does not constitute part of any group having any relation to ISI stock.

/s/ JOHN D. MURCHISON.

Subscribed and sworn to before me this 20th day of August, 1956.

[Seal] /s/ IRENE KERSHNER,
Notary Public in and for the County of Santa Fe,
State of New Mexico.

My commission expires October 7, 1958.

[Title of District Court and Cause.]

**AFFIDAVIT OF S. W. RICHARDSON
ON BEHALF OF DEFENDANTS**

State of California,

County of San Diego—ss.

S. W. Richardson, being first duly sworn, deposes and says:

I am a resident of Fort Worth, Texas, and I am engaged individually in various enterprises and in making various investments. I am also a partner with Perry R. Bass in a co-partnership of Richardson & Bass, engaged in oil drilling ventures.

In the month of May, 1956, Richardson & Bass purchased 21 shares (now 21,000 shares in view of subsequent split-up) of the capital stock of Insurance Securities Incorporated, hereafter called ISI. The transaction was handled through Kaiser & Co., investment bankers of San Francisco, California. Shortly afterwards Richardson & Bass transferred 10,000 of the shares to Perry R. Bass and 11,000 shares to me, and said ISI shares ceased to be owned by the partnership of Richardson & Bass.

In consideration of the fact that the option to purchase, on the basis of which the acquisition was made, belonged to Kaiser & Co., an agreement was entered into between me and Kaiser & Co. whereby the latter received an interest of 20% in said 11,000

shares and possesses the absolute right to vote 2200 shares of ISI stock as it sees fit.

Apart from this agreement with Kaiser & Co., I do not have any understanding, arrangement or contract with Kaiser & Co., Leland M. Kaiser, Perry R. Bass, or with anyone else who owns any ISI stock or possesses any beneficial interest therein, or anyone at all, concerning ISI stock or the voting thereof or any purchase and sale thereof to be made hereafter. I am not affiliated with anyone in respect of any ISI stock, and I am not part of any group owning or possessing any ISI stock or beneficial interest therein other than the relationship stated above with Kaiser & Co. I am free to exercise my own individual judgment with respect to voting my ISI stock, or interest therein, and intend to do so at all times.

/s/ S. W. RICHARDSON.

Subscribed and sworn to before me this 21st day of August, 1956.

[Seal] /s/ JEANNE W. HART,
Notary Public in and for
Said County and State.

My commission expires June 20, 1958.

[Title of District Court and Cause.]

AFFIDAVIT OF PERRY R. BASS ON
BEHALF OF DEFENDANTS

State of Texas,
County of Tarrant—ss.

Perry R. Bass, being first duly sworn, deposes and says:

I am a resident of Fort Worth, Texas, and I am engaged individually in various enterprises and in making various investments.

In May, 1956, I became the owner of 10,000 shares of the capital stock of Insurance Securities Incorporated, hereafter called ISI.

In consideration of the fact that the transaction, on the basis of which the acquisition was made, originated through Kaiser & Co., investment bankers, an agreement was entered into between me and Kaiser & Co. whereby the latter received an interest in 20% of said 10,000 shares and possesses the absolute right to vote 2,000 shares of ISI stock as it sees fit.

Apart from this agreement with Kaiser & Co., I do not have any understanding, arrangement or contract with Kaiser & Co., Leland M. Kaiser, S. W. Richardson, or with anyone else who owns any ISI stock or possesses any beneficial interest therein, or anyone at all, concerning ISI stock or the voting thereof or any purchase and sale thereof to be made hereafter. I am not affiliated with anyone in respect of any ISI stock, and I am not part of any group

owning or possessing any ISI stock or beneficial interest therein other than the relationship stated above with Kaiser & Co. I am free to exercise my own individual judgment with respect to voting my ISI stock, or interest therein, and intend to do so at all times.

/s/ PERRY R. BASS.

Subscribed and Sworn to Before Me this 23rd day of August, 1956.

[Seal] /s/ DORA NEELY,
Notary Public in and for
Tarrant County, Texas.

State of Texas,
County of Tarrant—ss.

Before me, the undersigned, a Notary Public in and for said County and State, on this day personally appeared Perry R. Bass, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

Given under my hand and seal of office this, the 23rd, day of August, 1956.

[Seal] /s/ DORA NEELY,
Notary Public in and for
Tarrant County, Texas.

Receipt of copy acknowledged.

[Endorsed]: Filed August 24, 1956.

[Title of District Court and Cause.]

PLAINTIFF'S REPLY TO DEFENDANTS'
REQUEST FOR ADMISSIONS OF FACT

Plaintiff believes that the subject matter set forth in defendants' Request for Admissions of Fact is not relevant to the causes of action set forth in the complaint and the amendment thereto, both filed on August 13, 1956, and without conceding the relevance thereof states as follows:

1. Plaintiff admits that paragraph I of the Request for Admissions of Fact sets forth the statement issued by Chairman J. Sinclair Armstrong, which statement is part of Litigation Release No. 1007, dated August 13, 1956, but further states that the Chairman's public statement was issued after the filing of the complaint and the amendment thereto and in response to an appeal by Leland M. Kaiser, who indicated in substance that public knowledge of the Commission's action might cause anxiety and misapprehensions among investors in the Trust Fund and might precipitate substantial redemptions which the Trust Fund would be forced to meet through liquidation of portfolio and that such forced liquidations might result in losses to the Trust Fund and to investors in the Trust Fund. A copy of the full text of the Commission's Release is attached hereto.

2. Plaintiff does not contend and charge in its complaint that "any defendant has mismanaged or misappropriated any assets of the Trust Fund" in

the sense that the Commission does not charge defendants with improper investment practices and policies resulting in investment losses, or with larceny, theft or embezzlement or acts of a similar character. Plaintiff further states that neither this statement nor the Chairman's statement is intended to modify or alter in any way the allegations set forth in the Commission's verified complaint filed on August 13, 1956, and more particularly paragraphs 20 and 21 thereof.

/s/ THOMAS G. MEEKER,
General Counsel;

/s/ AARON LEVY,
Attorney;

/s/ F. E. KENNAMER, JR.,
Attorney, Securities and
Exchange Commission.

Dated: August 27, 1956.

Securities and Exchange Commission
Washington 25, D. C.

The Securities and Exchange Commission announced today that it had filed a complaint in the United States District Court for the Northern District of California alleging that Insurance Securities, Inc., and Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan and Roy A. Haight, its officers and directors, have transferred control of that company

and the management and underwriting contracts with Insurance Securities, Inc., Trust Fund in contravention of certain fiduciary standards under the Investment Company Act of 1940.

The sole business of Insurance Securities, Inc., is as sponsor, depositor, investment adviser and principal underwriter of the Trust Fund, a mutual fund with \$215,000,000 of assets, whose Participation Certificates are held by the public. In connection with the filing of the action, Chairman J. Sinclair Armstrong of the Commission issued the following statement:

“The investors in the Trust Fund, managed and sponsored by Insurance Securities, Inc., should not be injured in any way whatsoever by the action taken today by the Securities and Exchange Commission. The suit brought by the Commission is intended to assure to investors legal protection which the Commission believes was intended by the Congress in the Investment Company Act of 1940. We want to emphasize that the action does not concern the investments in insurance stocks nor the portfolio of the Trust Fund, nor the manner in which Insurance Securities, Inc., has managed the funds invested in Trust Fund.

“The complaint does not allege that the defendants have mismanaged or misappropriated any of the assets of the Trust Fund. The filing of the complaint is not intended to disturb

the value of investments in the Trust Fund which as of December 31, 1955, totaled about \$215,000,000.”

The Commission’s complaint alleges that certain controlling stockholders of the sponsor company, Insurance Securities, Inc., sold their stock interests to a small group of purchasers at a price which was \$4,240,000 in excess of the book value of such stock. It is alleged that this transfer of control constituted an assignment of the investment advisory and underwriting contracts, which under the Act automatically constituted a termination of such contracts; that the right to enter into new contracts belonged to the Trust Fund and its certificate holders, along with any profits to be derived from the making of such contracts; and that the purported to transfer could not properly be effected by the individual defendants, who stand in a fiduciary relationship to the Trust Fund and accordingly may not themselves profit by such transfer.

The Commission seeks a court order pursuant to Section 36 of the Investment Company Act enjoining Insurance Securities, Inc., from acting as principal underwriter and investment adviser for the Trust Fund, and an accounting for any profits made by certain of its stockholders, officers and directors through their sale of a controlling interest in Insurance Securities, Inc.

The Commission is represented in the action by Thomas G. Meeker, its General Counsel, and Aaron

Levy and Franklin E. Kennamer, Jr., Commission attorneys.

Litigation Release No. 1007.

August 13, 1956.

Duly verified.

Proof of service attached.

[Endorsed]: Filed August 29, 1956.

[Title of District Court and Cause.]

SECOND INTERLOCUTORY ORDER

The Securities and Exchange Commission having filed in this action a motion for a preliminary injunction, and the defendants having moved to dissolve the Interlocutory Order entered by this Court on August 14, 1956, and for other and further relief, and upon the consent of the parties hereto,

It Is Ordered as follows:

1. That the Interlocutory Order entered on August 14, 1956, is hereby dissolved, and the motion for a preliminary injunction is withdrawn;

2. That the dissolution of the Interlocutory Order, as provided in paragraph 1 hereof, is subject to the following conditions, upon which the plaintiff and the defendants have agreed:

a. Pending a final determination of this action, the proxies of investors in the Trust Fund shall not

be voted on the adjourned day of the meeting of investors in the Trust Fund, nor at any time thereafter, for the election of Abe P. Leach and Roy A. Haight as directors of the Trust Fund;

b. Pending a final determination in this action, the defendants Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan and Roy A. Haight shall not serve as directors of the Trust Fund, or in a similar capacity;

c. Pending a final determination in this action, if dividends are declared by Insurance Securities Incorporated, the dividends on the stock owned or held directly, beneficially or otherwise, by the defendants Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan and Roy A. Haight, if paid, shall be segregated and withheld by Insurance Securities Incorporated;

d. Pending a final determination in this action, the remuneration provided for the defendants and other directors who are also officers of Insurance Securities Incorporated shall not be increased, provided that the remuneration of any officer may be increased to the extent of any decreases in the remuneration of any other officer or officers;

e. Pending a final determination in this action, the defendants Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight, and Abe P. Leach with respect to 1,000 shares, shall not sell, or engage to sell, their remaining stock interests in Insurance Securities Incorporated;

3. That the order herein shall be without prejudice to the power and jurisdiction of the Court to grant any and all relief, to the extent appropriate, sought by the plaintiff and deemed by the Court equitable and just, including any action with respect to the Investment Advisory and Principal Underwriting Contracts, whether or not approved by Investors in the Trust Fund, if it is determined in a final decree that plaintiff is entitled to judgment;

4. That defendants' motion to dismiss the complaint and for other and further relief is hereby continued to Friday, 10:00 a.m., November 2, 1956.

/s/ LOUIS E. GOODMAN,

United States District Judge.

Dated: August 30th, 1956.

The parties hereto stipulate to the entry of the foregoing order:

/s/ AARON LEVY,

Securities and Exchange Commission, Washington
25, D. C.;

/s/ F. E. KENNAMER, JR.,

Securities and Exchange Commission, 821 Market
Street, San Francisco 3, California, Counsel for
Plaintiff.

/s/ MOSES LASKY,

/s/ PHILIP S. ERLICH,

/s/ ALFRED JARETZKI, JR.,

/s/ ELWOOD MURPHEY,

Counsel for Defendants.

[Endorsed]: Filed August 30, 1956.

[Title of District Court and Cause.]

ANSWER OF SECURITIES AND EXCHANGE
COMMISSION IN OPPOSITION TO DE-
FENDANTS' MOTIONS TO DISMISS AND
FOR SUMMARY JUDGMENT

The Securities and Exchange Commission, plaintiff herein, opposes defendants' motions to dismiss and for summary judgment on the ground that the motions are without merit and that the factual issues raised by the defendants are not subject to disposition on motion.

Attached hereto are the following affidavits: (1) The Affidavit and Supplemental Affidavit of Jack I. Elias; (2) the Affidavit of Lawrence M. Greene; and (3) the Affidavit of Charles H. Eisenhart.

An accompanying memorandum of law is also submitted herewith.

Dated: October 23, 1956.

/s/ THOMAS G. MEEKER,
General Counsel;

/s/ AARON LEVY,
Special Counsel, Securities
and Exchange Commission;

/s/ F. E. KENNAMER, JR., A.L.
Attorney, Securities and
Exchange Commission.

[Title of District Court and Cause.]

AFFIDAVIT

Washington,

District of Columbia—ss.

Jack I. Elias, being duly sworn on his oath according to law, deposes and says:

(1) I am employed as a Financial Analyst and Attorney by the Securities and Exchange Commission and assigned to its Division of Corporate Regulation;

(2) Said Division of Corporate Regulation is charged with the administration of the regulatory provisions of the Investment Company Act of 1940;

(3) My duties as Financial Analyst and Attorney relate primarily to the examination and review of documents filed under the Investment Company Act of 1940 to determine compliance with the applicable provisions of said Act and the Rules and Regulations promulgated thereunder;

(4) On July 2, 1956, Insurance Securities Incorporated sponsor, principal underwriter and investment adviser of the Trust Fund, an open-end diversified management company registered under the Investment Company Act of 1940, filed with the Commission preliminary proxy material pursuant to Section 20 (a) of the Investment Company Act of 1940 and Regulation X-14 under the Securities Exchange Act of 1934 in connection with a special meeting of Investors Holding Participating Agree-

ments in the Trust Fund to consider and act upon, among other things, proposals to amend the Amended Trust Agreement, as amended and supplemented, to reinstate the Principal Underwriting Contract and the Investment Advisory Contract with Insurance Securities Incorporated;

(5) Upon examination of the proxy material, I noted the following statement:

“Upon consummation of this sale, the old stockholders of the Company, being those who have held stock for over 16 years, will hold less than a majority of its shares, to be precise 45.78% thereof, and the Company is advised that this change in majority ownership may be considered an assignment of the contract between the owners of the Trust Fund and the Company concerning matters of Investment Advisory and Principal Underwriting, as defined in the Investment Company Act of 1940. Under the terms of such contract and such Act, a termination of the contract takes place upon its assignment.”

(6) It appeared to me that in connection with the transfer of the controlling stock of Insurance Securities Incorporated a question should be raised whether there was an assignment of the investment advisory and underwriting contracts for a consideration in contravention of the principles enunciated in the Commission's General Counsel's Opinion dated May 11, 1942 (Investment Company Act Release No. 354).

(7) Said Opinion of the General Counsel states, in effect, that the receipt of consideration for the purported assignment of an investment advisory contract constitutes gross misconduct and gross abuse of trust subject to Commission action under the provisions of Section 36 of the Investment Company Act of 1940.

(8) Resolution of the problem thus raised required additional information concerning the transfers of stock of Insurance Securities Incorporated not disclosed in the proxy statement.

(9) I orally advised the Division of Corporation Finance that we intended to raise the Section 36 problem with the company and to request additional information.

(10) Said Division of Corporation Finance adverted to this problem in its letter of deficiencies dated July 10, 1956, a copy of which is attached hereto as Exhibit I sent via air mail to the company, as follows: "We understand that our Division of Corporate Regulation has raised certain questions regarding the assignment of the Investment Advisory and Underwriting Contracts."

(11) On or about July 13, 1956, I telephoned Mr. R. A. Haight, Secretary of Insurance Securities Incorporated at their offices in Oakland, California. Mr. Haight acknowledged receipt of the aforementioned letter of the Division of Corporation Finance and had noted the reference therein to the assignment problem. I discussed the Section 36 problem

and requested the following information which I explained was necessary to a resolution of the problem:

(a) Full details with respect to (1) the transactions whereby Kaiser & Co., Latmarco Incorporated, Lamar Life Insurance Company, Atlantic Life Insurance Company and D. D. Harrington acquired their present holdings of the stock of Insurance Securities Incorporated; and (2) the pending sale by Mr. Abe Leach of his present holdings.

(b) In connection with the foregoing, the information particularly desired was the identity of the transferors; the prices assigned to the stock transferred, how computed; the book value of the stock as of the transfer date or dates; and whether any value was assigned to the investment advisory and/or underwriting contracts.

(c) Copies of the balance sheets of Insurance Securities Incorporated as of December 31, 1954; June 30, 1955; December 31, 1955, and June 30, 1956.

(12) The mailing of the proxies by Insurance Securities Incorporated was also discussed. I told Mr. Haight that the decision with respect to the mailing of the proxies was up to the management of Insurance Securities Incorporated. I further advised Mr. Haight that the matter of mailing the proxy material should be considered in the light of the Section 36 problem we had raised and that if there was a mailing before we had studied the matter, they would have to assume the risk that the

Commission may resolve the problem adversely to them.

(13) I also informed Mr. Haight that our files contained a memorandum of a conference held on September 20, 1955, in the offices of the Commission at which Edward Murphey, a director of Insurance Securities Incorporated and also a partner of a law firm which performs legal services for the company, and William Bowen were present. According to the memorandum, the legal consequences under the Act of the transfer of controlling stock of Insurance Securities Incorporated was explored. I particularly noted the statement in the memorandum that since no definite proposal was made, it was suggested that if some sales program develops inquiry should be made to the Commission as to whether such program under given circumstances would be considered as contravening the principles stated in Investment Company Act Release No. 354. I stated that to my knowledge the preliminary proxy material constituted the first notice that any program for the sale of the stock of Insurance Securities Incorporated had been formulated.

(14) Mr. Haight agreed to furnish the material requested.

(15) On or about July 18, 1956, Mr. Alfred Jaretski, Jr., of the law firm of Sullivan & Cromwell informed me by telephone that he was counsel for Insurance Securities Incorporated in this matter and any further discussion concerning the as-

signment problem should be addressed to him. He also informed me that Mr. Haight was assembling the information I requested and that it would be mailed to me soon.

(16) Mr. Jaretski and I discussed the assignment problem briefly and he indicated his disagreement with the General Counsel's Opinion of May 11, 1942, referred to hereinbefore. He further expressed the opinion that the transfers of stock of Insurance Securities Incorporated under review did not contravene the principles of said General Counsel's Opinion of May 11, 1942.

/s/ JACK I. ELIAS,
Securities and Exchange
Commission.

Subscribed and sworn to before me on this 11th day of August, 1956.

[Seal] /s/ CARL J. BIRCKNER,
District of Columbia.

My commission expires April 14, 1959.

EXHIBIT I.

Air Mail.

July 10, 1956.

Mr. R. A. Haight, Secretary,
Insurance Securities Incorporated,
2030 Franklin Street,
Oakland 12, California.

Re: File No. 811-87.

Dear Sir:

On the basis of information now available, we have the following comments with respect to the preliminary proxy soliciting material (received July 2, 1956) for the meeting of investors on August 15, 1956.

The procedure specified by the statute of California with respect to revocation of proxies should be stated under "Voting of Proxies" (first page), pursuant to item 1 of regulation X-14.

The second paragraph on the second page should be revised to state that a majority of the directors not parties to the contract will have the power to approve the contract, as provided by section 15 (c) of the Investment Company Act of 1940.

The information required by item 5 (b) with respect to the record date should be included.

The fifth paragraph on the last page should be expanded to include a brief outline of the dissenters rights, as required by item 2. Since it appears that such rights may be exercised only within a limited

time after the date of adoption of the proposals (60 days after mailing of the notice) a statement whether the persons solicited will be notified of such date should also be included.

It is suggested that consideration be given to furnishing to those persons solicited who became Investors since the mailing of the issuer's annual report to investors a copy of such annual report.

We understand that our Division of Corporate Regulation has raised certain questions regarding the assignment of the Investment Advising and Underwriting Contracts.

It is assumed that appropriate revision of the issuer's 1933 Act registration statement will be made to reflect the results of the meeting.

Very truly yours,

CHARLES H. EISENHART,
Assistant Director, Division
of Corporation Finance.

[Title of District Court and Cause.]

SUPPLEMENTARY AFFIDAVIT OF
JACK I. ELIAS

Washington,
District of Columbia—ss.

Jack I. Elias, being duly sworn on his oath according to law, deposes and says by way of supple-

menting his previous affidavit dated August 11, 1956:

I.

1. I have read the affidavit of Roy A. Haight, Secretary of ISI, filed on behalf of the defendants herein. Mr. Haight states in his affidavit:

“I asked Mr. Elias whether I was free to mail the proxy solicitation material or whether there was anything in the telephone call which affected my doing so. Mr. Elias did not at any time state, suggest or intimate that, in order to avoid a charge of being false or misleading, the proxy solicitation material should contain any reference to the so-called Section 36 problem or the facts connected therewith.”

This is not inconsistent with the statement in my affidavit of August 11, 1956, filed herein, that “The mailing of the proxies by Insurance Securities Incorporated was also discussed. I told Mr. Haight that the decision with respect to the mailing of the proxies was up to the management of Insurance Securities Incorporated. I further advised Mr. Haight that the matter of mailing the proxy material should be considered in the light of the Section 36 problem we had raised and that if there was a mailing before we had studied the matter they would have to assume the risk that the Commission may resolve the problem adversely to them.”

2. The information requested in my telephone conversation with Mr. Haight on July 12, 1956, was

necessary to a determination of whether Commission action pursuant to Section 36 of the Act should be instituted.

3. The Commission's official records show that the information requested of Mr. Haight in the telephone conversation of July 12, 1956, was set forth in a memorandum attached to a letter dated July 24, 1954, signed by Alfred Jaretzki, Jr., which was received in the mail by the Commission on July 25, 1956. The Commission's records also show that the definitive proxy solicitation material was mailed by ISI on or about July 17, 1956.

4. That memorandum stated, among other things, (a) the sales price of \$50 per share for the stock of ISI sold by the defendants, (b) that Leland Kaiser arranged the purchases of the ISI stock from the defendants, and (c) the arrangements respecting the distribution of the stock among the purchasers, all of which information was vital and relevant to the staff determination to recommend to the Commission the institution of the Section 36 proceedings against the defendants herein.

II.

5. A letter dated January 25, 1956, between Kaiser & Co. and C. W. Murchison, a copy of which is attached hereto as Exhibit A, which was made available to the Commission subsequent to the filing of the complaint in the proceedings herein, discloses, among other things:

(a) Kaiser & Co. proposed to Mr. Murchison that the 40 shares of ISI (subsequently reclassified into 40,000 shares) representing 24.0964% of the shares then outstanding on which Kaiser & Co. had an option to purchase, be acquired as a joint venture with Kaiser & Co. contributing the option and certain expenses and the other parties contributing the cash price, although it was suggested that it was "preferable to purchase the shares in blocks of 10 each in 4 separate, unrelated accounts, * * *"

(b) It was further suggested that parties to the joint venture be corporations because of tax considerations.

(c) That any party may terminate joint venture arrangement by presenting a bona fide purchaser for the stock subject to the right of the other parties to meet such offer.

III.

6. Subsequent to the filing of the complaint by the Commission in the proceedings herein, a copy of a letter dated February 17, 1956, addressed to Abe P. Leach and signed by Leland M. Kaiser was made available to the Commission. Said letter purported to exercise an option previously granted Kaiser & Co. to purchase 8 shares of ISI (8,000 shares subsequent to stock split by ISI) owned by Mr. Leach at a price of \$50,000 per share. Said letter contains the following paragraph:

"You agree that so long as you shall remain, or ceasing to be, if you shall again become, a

director or stockholder of the company, you will exert your best efforts (i) to cause Leland M. Kaiser and William H. Bowen to be elected to the Board of Directors of the company, (ii) to cause the company to employ Leland M. Kaiser, so long as he shall be qualified, on a part-time basis as a Vice-President and member of the Executive Committee at an annual salary of \$24,000 for a period of one and one-half ($1\frac{1}{2}$) years from Closing Date, (iii) to keep and maintain the present dividend policy of the company, and (iv) for a period of three years from Closing Date or such other period as may be mutually agreeable, to vote salary increases for only such officers or employees of the company as do not presently occupy the four principal and highest salaried positions of President, Vice-President and Treasurer, Secretary, and Vice-President of the company.”

7. Copies of similar letters dated February 17, 1956, addressed to Roy A. Haight and A. J. Loneragan, purporting to exercise options theretofore granted Kaiser & Co. to purchase 8 shares (8,000 shares after the stock split) of ISI from each of the foregoing persons at \$50,000 per share were also furnished the Commission. Each of said letters contains the identical statement quoted above from the letter to Leach from Kaiser.

8. Subsequent to the filing of the complaint herein, copies of letters signed by Leland M. Kaiser

addressed to Messrs. Leach, Lonergan and Carr, defendants herein, were furnished to the Commission at its request. The letter of Mr. Leach carries a blank April, 1956, date and there is no indication of Mr. Leach's written acceptance thereof. The letter to Mr. Lonergan is dated April 25, 1956, and contains Mr. Lonergan's written acceptance as of the same date. The letter addressed to Mr. Carr carries a blank April, 1956, date but contains Mr. Carr's written acceptance dated April 25, 1956. Each of said letters contains an identical opening paragraph as follows:

"The undersigned, acting herein individually and as a member of the partnership firm of Kaiser & Co. and as agent and representative for other parties, hereby notifies you that he desires to, and does hereby, exercise the option dated March 27, 1956, granted to the undersigned by you to purchase from you five (5) shares of the common capital stock (hereinafter called the "Company") upon and subject to the terms, conditions and provisions heretofore agreed upon and hereinafter set forth."

9. Also furnished to the Commission at its request subsequent to the filing of the complaint herein is a copy of a specimen unsigned letter addressed to Leland M. Kaiser and dated March 27, 1956, reproduced in full below:

Copy

March 27, 1956.

Mr. Leland M. Kaiser,
c/o Kaiser & Co.,
1500 Russ Building,
San Francisco 4, California.

Dear Mr. Kaiser:

The undersigned hereby grants to you the right to purchase from him, on or before May 3, 1956, shares of the common capital stock of Insurance Securities Incorporated at \$50,000 per share, subject to the following conditions:

1. You agree that under no circumstances will you purchase for your own account more than $24\frac{3}{4}\%$ of such optioned shares, or of the total outstanding shares of Insurance Securities Incorporated, it being our understanding that this option is being obtained by you for the purpose of effecting distribution of more than 75% of said optioned shares among another purchaser or purchasers.

2. You agree than any purchaser or purchasers to whom you may assign the right to purchase all or any part of such optioned shares shall not as a result of such purchase hold individually a beneficial interest in, or a right to vote more than, $24\frac{3}{4}\%$ of the voting shares of Insurance Securities Incorporated.

Very truly yours,

.....

IV.

10. The prospectus of the Trust Fund dated as of October 15, 1955, filed with the Commission and contained in Commission's File No. 2-11021-1, states as follows on page 14:

“The Board of Directors of Insurance Securities Incorporated is composed of eleven members. As the Trust Fund has no officers or Board of Directors the officers and directors of Insurance Securities Incorporated render their services to the Trust Fund. Their only compensation, for services in connection with the Trust Fund, is paid by Insurance Securities Incorporated out of the fees allowed the company. They receive no compensation from the Trust Fund directly.”

11. Similar statements are contained in the Trust Fund's prospecti dated April 1, 1955; February 10, 1955; October 1, 1954; August 9, 1954; on file with the Commission and contained in Commission's File No. 2-11021-1.

/s/ JACK I. ELIAS,
Securities and Exchange
Commission.

Subscribed and sworn to before me on this 23rd day of October, 1956.

[Seal] /s/ NEVA M. BRINKLEY.

My Commission Expires: 12-1-58.

EXHIBIT A

January 25, 1956.

Mr. C. W. Murchison,
5307 East Mockingbird Lane,
Dallas, Texas.

Dear Clint:

Insurance Securities Incorporated ended the year 1955 with a trust portfolio value of \$215,500,000. There are 166 shares of stock outstanding.

As you know, we have been working on this matter for over a year and now have an option on 40 shares (24.0964% of the total) at a price of \$55,000 per share, although we feel there is a good chance we shall be able to consummate the purchase at \$50,000 per share.

It seems preferable to purchase the shares in blocks of 10 each in 4 separate, unrelated accounts, although this is not necessary. Assuming that Kaiser & Co. will have a 20% interest in each such account, as outlined later in this letter, and that for tax reasons the joint account members in each case are corporations (in order to gain the advantage of intercorporate tax rate on dividends), the following results may be anticipated.

The first set of estimates is, in our opinion, considerably lower than either past experience or current accomplishment would seem to justify.

Even though actual sales increased in 1955 at the rate of 87% and since 1950 by 600%, we have, in the interest of conservatism, assumed in the following example that the past spectacular growth rate has terminated and have projected new price of \$65,000,000 per annum over the next 10 years compared with \$63,000,000 in 1955.

	Corporate Investor	Kaiser & Co.
Original Investment	\$ 500,000	‡
Value in 1965 at 14 times earnings.....	\$1,414,000	\$353,000
Dividends received in ten-year period*....	\$ 498,000	\$125,000
Cost to amortize investment out of dividends with interest at 4%.....	\$ 513,000	\$128,000
Deficiency	\$ 15,000	\$ 3,000

*At 4% interest, it will require \$641,000 to amortize the original \$500,000 cost over a 10-year period. After deducting the intercorporate dividend tax, dividends available to meet the interest and amortization would amount to \$623,000.

‡Described hereinafter.

The foregoing estimates are based on Projection B on page 17 of our complete report. Details of their derivation are in Appendix A.

A more realistic estimate, in our opinion, is Projection C. This provides for \$70,000,000 of sales in 1956 and an annual increase of \$5,000,000 in new sales each subsequent year. In the interest of conservatism, it assumes a reduction in the sales charge from 8.85% to 8%. Under such assumptions, results would be as follows:

	Corporate Investor	Kaiser & Co.
Original investment	\$ 500,000	‡
Value in 1965 at 14 times earnings.....	\$1,677,000	\$419,000
Dividends received in ten-year period*....	\$ 571,000	\$143,000
Cost to amortize investment out of dividends with interest at 4%.....	\$ 507,000	\$127,000
Surplus	\$ 64,000	\$ 16,000

*At 4% interest it will require \$634,000 to amortize the original \$500,000 cost over a 10-year period. After deducting the intercorporate dividend tax, dividends available to meet the interest and amortization would amount to \$714,000.

‡Described hereinafter.

The foregoing estimates are based on Projection C on page 18 of our complete report.

Because of the very great growth which we believe to be inherent in the dynamic mutual fund business generally and ISI in particular, we think it only fair to point out that in our opinion there are many reasons to expect actual results to conform more closely to Projection E on page 18 of our complete report. This assumes \$75,000,000 of sales in 1956, which is an increase of only 21% over 1955, as against 1955's 87% increase over 1954. Further, it assumes a \$10,000,000 per annum sales increase in each subsequent year. Then in the interest of conservatism, it assumes a reduction in the sales charge from 8.85% to 7%, although no such decrease appears imminent at this time. Under these assumptions, results would be as follows:

	Corporate Investor	Kaiser & Co.
Original investment	\$ 500,000	‡
Value in 1965 at 14 times earnings.....	\$1,826,000	\$457,000
Dividends received in ten-year period*.....	\$ 624,000	\$156,000
Cost to amortize investment out of dividends with interest at 4%.....	\$ 502,000	\$125,000
Surplus	\$ 122,000	\$ 31,000

*At 4% interest it will require \$627,000 to amortize the original \$500,000 cost over a 10-year period. In this instance, sufficient revenues will become available in less than 9 years to complete the interest and amortization. After deducting the intercorporate dividend rate, dividends would amount to \$780,000 in the ten-year period.

‡Described hereinafter.

January 25, 1956.

It is proposed that the acquisition of the shares take the form of a joint venture or joint ventures. Kaiser & Co. will contribute its option, and the time and expense including, but not limited to, legal fees, travel and telephone costs, which it has incurred in working on the matter, to the joint venture or ventures. The other party, or parties, shall contribute enough cash to exercise the option and acquire their respective interests.

Until such time as the parties other than Kaiser & Co. have been reimbursed from the proceeds of sale of stock, or from dividends thereon, or both, for the actual amount of cash contributed, the net profits derived from the operation of the joint venture shall be apportioned entirely to such other parties. Thereafter, said net profits shall be appor-

tioned 80% to such other parties, and 20% to Kaiser & Co.

If at any time it is decided that the stock is to be sold prior to the recovery of the cost thereof by parties other than Kaiser & Co., then such other parties shall be reimbursed for their unrecouped cost, and any excess thereover shall be apportioned 20% to Kaiser & Co. and 80% to the other parties.

Any party may terminate the arrangement by presenting a bona fide purchaser for the stock subject to the right of the other parties within days to meet said offer. The proceeds from such sale shall be distributed as in the preceding paragraph.

I had hoped to see you and Jim together, Clint, but time is running against me. Therefore, I shall appreciate hearing from you at your earliest convenience.

Thanks for your letter, on receipt of which I immediately called Pat Brown. He agrees that a meeting at this time would be pointless.

My best to you,

Sincerely,

KAISER & CO.

LMK:B

[Title of District Court and Cause.]

AFFIDAVIT OF LAWRENCE M. GREENE

Washington,

District of Columbia—ss.

Lawrence M. Greene, being duly sworn, deposes and says:

1. I am an Assistant Director of the Division of Corporate Regulation of the Securities and Exchange Commission. I have immediate supervision of the regulatory functions of the staff of the Commission under the Investment Company Act of 1940. In this capacity it is my responsibility and duty, among other matters, to review the affairs and conduct of registered investment companies and affiliated persons to assure compliance with the Investment Company Act, and to make recommendations to the Director of the Division and to the Commission thereon.

I.

2. (a) On September 20, 1955, Elwood Murphey of Oakland, California, counsel for Insurance Securities Incorporated (ISI), and William H. Bowen, attorney of Dallas, Texas, conferred with me and Frank Field, an attorney in this Division, concerning problems raised as to the position of certain of ISI stockholders. After discussing the amount of stock held by ISI stockholders, and the relationship of that corporation to the Trust Fund, a registered investment company, Mr. Murphey pointed out that Abe P. Leach and Ossian E. Carr,

each of whom held about 18% of stock of ISI, were of advanced age and that consideration was being given either to a sale of their stock or the possible distribution of this stock by their heirs in the event of death.

(b) Mr. Murphey and Mr. Bowen indicated that they were fully aware of the Opinion of the General Counsel of the Commission contained in Investment Company Act Release No. 354, issued by the Commission on May 11, 1942, a copy of which is attached hereto as Exhibit A.

(c) Mr. Murphey and Mr. Bowen advised us that these stockholders of ISI then had no definitive plans for disposing of their shares of stock but that various possibilities were being considered in the light of the General Counsel Opinion. Both Mr. Murphey and Mr. Bowen indicated that the earnings of ISI were so large in relation to its assets that any sales price for the stock of the company based on earnings would obviously represent a consideration by the purchaser for the expectation of earnings from the underwriting and investment advisory services rendered to the Trust Fund. They further indicated their understanding that since these services were performed by ISI, a corporation, the sale of the stock of that corporation might contravene the principles enunciated in the aforesaid General Counsel Opinion if a controlling block were sold by one or more owners to a single person or a group of persons. The discussion encompassed various possible dispositions of stock including the

possibility that Mr. Leach and Mr. Carr would both sell their stock to a single purchaser or group of persons, thus involving an aggregate sale of 36% of the stock of Insurance Securities Incorporated. It was pointed out by us that, since the Investment Company Act provides that 25% of the voting securities of a company constitutes, presumptively, a controlling block of stock (Section 2(a)(9)), such a sale would in our view involve a transfer of control and would constitute an "assignment" under Sections 2(a)(4) and 15(a) and (b) of the Investment Company Act.

(d) Mr. Murphey and Mr. Bowen observed that if one of the stockholders were to try to sell his holdings of 18% alone he would get much less for his stock than if he sold jointly with another stockholder or stockholders and both sold 36% or more of the stock. Our answer to this observation was that realistically this showed the validity of the premise on which the General Counsel Opinion was based.

(e) Mr. Murphey and Mr. Bowen made clear to me in our conference that no actual proposal was being considered. I suggested that if a definite proposal for disposition of the stock developed, inquiry should be made to the Commission as to whether the proposed program would be considered as contravening the principles set forth in the 1942 General Counsel Opinion. I also informed them that the Commission would shortly have to render an opinion on a case which raised the same general problems

which we were discussing; I volunteered to get in touch with them if anything developed as a result of the Commission's review of the matter which could appropriately be discussed with them.

3. At about the time that the foregoing conference was held, I was informed by Commissioner A. Downey Orrick that Mr. Leland M. Kaiser of San Francisco, California, had conferred with him on September 21, 1955, regarding the ISI matter. I advised Commissioner Orrick that another case involving the same general problem would come before the Commission for consideration and that I had advised Mr. Murphey and Mr. Bowen that I would get in touch with them. Commissioner Orrick wrote to Mr. Kaiser, referring to these facts in a letter dated September 23, 1955.

Commissioner Orrick's letter included the following statement:

"I am informed that Mr. Greene had told Mr. Murphey that another matter involving a similar question will soon be coming before the Commission for consideration and that Mr. Greene stated he would inform Mr. Murphey of the Commission's thinking on that matter."

4. Thereafter Mr. Kaiser sent a letter, dated October 3, 1955, to Commissioner Orrick in which Mr. Kaiser discussed in detail the difficulties that he saw in the 1942 General Counsel Opinion. This letter, attached hereto as Exhibit B, indicates that

Mr. Kaiser was fully aware of the implications of that Opinion, and of its applicability to the sale of a controlling block of ISI stock.

5. Commissioner Orrick acknowledged receipt of Mr. Kaiser's letter on October 13, 1955. Thereafter, on November 10, 1955, I wrote to Mr. Kaiser, referring to his letter of October 3, 1955, and to the similiar problem considered by the Commission in another case to which I had adverted in my conference with Mr. Murphey and Mr. Bowen, and which was mentioned in Commissioner Orrick's letter of September 23, 1955. I advised Mr. Kaiser that the Commission, following the principles enunciated in the 1942 General Counsel Opinion, had reached the conclusion that the receipt of consideration for the purported assignment of an investment advisory contract and an underwriting contract constituted gross misconduct and gross abuse of trust subject to Commission action under the provisions of Section 36 of the Investment Company Act of 1940. While recognizing that personal difficulties were raised by the situation mentioned in Mr. Kaiser's letter, I stated that any substantive departure from the principles laid down in the General Counsel Opinion would create even greater problems contrary to the interest of public investors. A copy of this letter is attached hereto as Exhibit C.

6. Mr. Kaiser acknowledged receipt of my letter on November 15, 1955. A copy of this letter is attached as Exhibit D.

II.

7. On July 25, 1956, I received a telephone call from Mr. Alfred Jaretzki, who asked me whether we had received the information and data which the staff had requested from Mr. Haight on July 12, 1956. I advised him that I had been on vacation and was not familiar with the matter. He stated that he was planning to make a trip to Europe and that if there was anything that the staff wanted in the way of information, or if something were to occur prior to the meeting of investors scheduled for August 15, 1956, he wanted to know. I promised to look into the matter and would call him the following day.

8. After studying the material furnished by Mr. Jaretzski contained in a letter and memorandum dated July 24, 1956, and received by the Commission on July 25, 1956, I telephoned him and discussed with him the questions raised by the sale of ISI stock for \$50 per share as set forth in that memorandum. After some discussion between us as to the applicability and merits of the 1942 General Counsel Opinion, I stated to him that I could not advise him as to whether or not the Commission would or would not take any action prior to the meeting to be held on August 15.

Mr. Jaretzki pointed out that there was the possibility that the Commission might wish to take some action with respect to the meeting to be held on August 15, although he emphasized that the sale of 16,000 shares of stock of Investors Securities Incor-

porated held by Mr. Leach was not to be consummated until thirty days later which would give the Commission ample time to take action regarding that transaction. There was some discussion between us as to whether the Commission might wish to enjoin the meeting and I also mentioned the possibility that the Commission might insist that additional proxy material be sent to investors. I said that since the Director of the Division and the General Counsel were out of the City, that I could not give him a definite answer then, but would consult further with the staff and would call him again the following day.

9. On July 27, 1956, I telephoned Mr. Jaretzski and advised him that after further discussions with the staff I could not give him any assurance that the Commission would or would not take action prior to August 15, 1956, the day of the meeting of investors.

/s/ LAWRENCE M. GREENE,
Securities and Exchange
Commission.

Subscribed and sworn to before me on this 23rd day of October, 1956.

[Seal] /s/ NEVA M. BRINKLEY,
Notary Public.

My Commission Expires 12-1-58.

EXHIBIT A

For Immediate Release Monday, May 11, 1942

Securities and Exchange Commission
Philadelphia

Investment Company Act of 1940

Release No. 354

The Securities and Exchange Commission today made public an opinion of its general counsel, Chester T. Lane, to the effect that an investment adviser of a registered investment company cannot legally profit by an attempt to sell his investment advisory contract with the company.

Mr. Lane points out that under Sections 15 (a) and (d) of the Investment Company Act of 1940, investment advisory contracts with registered investment companies are not legally saleable. The opinion goes on to state that, as is recognized by the statute, a fiduciary relation exists between an investment adviser and an investment company. Consequently, the receipt of a consideration for any purported assignment of such a contract will constitute gross misconduct and gross abuse of trust, subject to Commission action under Section 36 of the Act. It is also stated that this principle applies to any situation in which an investment adviser attempts to obtain a consideration for a purported transfer to some third person of his fiduciary obligations toward the stockholders of the registered investment company, irrespective of the form of the particular

transaction, the manner in which the consideration is to be received, or the source of payment.

The opinion points out that an investment adviser's position is similar to that of a trustee, officer or director and that he is under the same disability to sell his trust.

The text of the opinion is as follows:

I understand that a certain registered investment company has a contract calling for investment advisory services from A, a corporation. This contract constitutes substantially all of A's assets. X owns the controlling block of stock of A. B, a corporate investment advisor, is desirous of acting as investment adviser to the investment company. Various proposals have been made with a view toward accomplishing that result.

Under the first proposal X will transfer to B his controlling interest in A for a substantial consideration. Thereafter, a new written investment advisory contract with A, which complies with the requirements of Section 15 (a) of the Investment Company Act, will be made. As an alternative proposal it is contemplated that a contract will be entered into by A and X with B whereby A or X will receive a substantial sum in consideration of their undertaking to terminate the investment advisory contract with the investment company in order to permit B to enter into a new written contract with the investment company.

As a further alternative it is proposed that A and B will merge, the terms of the merger giving X substantial compensation in stock or cash for his interest in A. A new contract with the company resulting from the merger will be entered into by the investment company. Still another proposal is that B will merely undertake to perform the functions of investment adviser under A's contract with the investment company for its duration, while A continues to receive the compensation due thereunder with the understanding that upon the expiration of the contract, a new contract with B will be entered into.

In each case it is intended that the new arrangement will be approved by the directors of the investment company and submitted to the stockholders of that company for approval.

You inquire whether a violation of the Investment Company Act of 1940 will be involved if any of these proposals is effected.

Section 15 (d) of the Investment Company Act in effect provides for the automatic termination of investment advisory contracts made prior to March 15, 1940, upon the assignment thereof after that date. Section 2 (a) (4) of the Act provides that the term "assignment" includes any direct or indirect transfer or hypothecation of a contract or chose in action by the assignor, or of a controlling block of the assignor's outstanding voting securities by a stockholder of the assignor. In my opinion, each

of the various proposals mentioned above would involve an "assignment" within the meaning of the Act of the investment advisory contract which A has with the investment company. Consequently, by reason of Section 15 (d) of the Act, that contract would be automatically terminated upon such assignment, and no person could lawfully purport to act as investment adviser thereunder.

The legislative history of Section 15 manifests a clear Congressional intention to prevent all trafficking in investment advisory contracts and to prevent an investment adviser from transferring his fiduciary obligations by turning over the management of the stockholders' money to a different person. That intention is effectuated by the requirement in Section 15 (a) that every investment advisory contract made after March 15, 1940, must provide for its automatic termination upon assignment. Section 15 (d) provides that contracts made before March 15, 1940, also terminate upon assignment.

Thus, Congress has said that an investment adviser cannot assign his contract and cannot transfer his fiduciary obligations. In the light of these prohibitions, and in the light of the fiduciary relationship which exists between an investment adviser and the company which he serves, it is my opinion that an investment adviser who directly or indirectly attempts to obtain a consideration for the purported transfer of his contract is guilty of gross misconduct and gross abuse of trust subject to Commission action under Section 36 of the Act. This

principle applies to any situation which in substance represents an attempt by an investment adviser to profit by a purported sale of his fiduciary obligations, irrespective of the form of the particular transaction involved, the manner in which the consideration is to be received or the source of payment. In my opinion the legal status of an investment adviser is similar to that of a trustee of a trust or a director or officer of a corporation, and the investment adviser is under the same prohibitions against selling his trust.

Looking through the form of the alternative proposals which you have described to their substance, it is my view that A would in each case be guilty of gross misconduct and gross abuse of trust.

EXHIBIT B

Kaiser & Co.
Investment Bankers
Russ Building
San Francisco 4

October 3, 1955.

Mr. Andrew Downey Orrick, Commissioner,
Securities & Exchange Commission,
425-2nd Street, N.W.,
Washington, D. C.

Dear Mr. Orrick:

Your letter of September 23 relating to our recent conversation in Washington is much appreciated. Not knowing the facts in the matter which you state will soon be before the Commission, I, of course, have no way of estimating whether or not the thinking in that case will shed much light on our problem.

Because of the brief time we were together, and I realize you stretched a point to afford me the opportunity, I was not able to explain more fully my thoughts in connection with the Lane opinion as released in 1942. I have read this opinion and have discussed it with counsel. As I understand the situation, it was the intent of the Legislature (among other things), in adopting Section 15 of the Investment Company Act of 1940, to prevent trafficking in investment advisory contracts and to prevent an investment adviser from transferring his fiduciary obligations. Mr. Lane considers the sale of a controlling stock interest in a company holding an investment advisory contract as the equivalent of the sale of the investment advisory contract and as such, a gross breach of the seller's fiduciary obligations to the investors. It is my understanding that the technical staff believes that the same principle is applicable to underwriting contracts where the same company controls the underwriting contract and the investment advisory contract. Mr. Lane compares the investment adviser to a Trustee of a trust or a Director or officer of a corporation and

states that all are under the same prohibitions against selling their "trusts."

' I am in accord with the position that the Commission should retain some control over the transfer of investment advisory contracts, but it does not seem to me that the Lane Opinion is realistic in the light of present day conditions. It is obvious that any contract for investment advisory service or any contract of an underwriting character is entered into with the expectation that the person performing the required services will be compensated for these services. As investment trusts grow, the sponsor company will grow, with the result that the value of the stock of such company will similarly grow. It is inevitable that in the ordinary course of events, sales will be made and must be made of the stock of sponsor companies. Some such sales will take place as the result of death; others, as an incident to retirement, changes in employment, or orderly estate planning. Such sales are going to be made at market value and if an individual stockholder, or stockholders collectively, cannot sell a controlling interest at value, it will result in the splitting of stockholdings and the sale of stock in small units to a large number of stockholders. This will have the effect of placing the control of investment advisory contracts in the hands of many. It would seem to me that the better procedure on the part of the Commission would be to encourage control of this type of company by persons experienced in the field which would probably require the reten-

tion of such control in a relatively few hands, rather than the widespread holding of such stock.

Further, I do not believe that it is accurate to say in all instances that a contract involving a trust relationship may not be sold or transferred. While there are many situations in which a Trustee may not transfer his obligations, there are numerous situations comparable to the investment adviser situation in which a transfer is permitted. Thus, in the merger of two banks or in the sale of bank stock, there is included in the sale or merger the business done by the Trust Department and, necessarily, the profit derived by the Trust Department from its activities is a material element in the determination of sales price. We have numerous trust and escrow companies in which there is a fiduciary relationship, and yet the free sale of stock is permitted.

Referring to Mr. Lane's own comparison, it is common for a Director or Officer owning a controlling interest in a corporation to sell his stock without claimed breach of a fiduciary duty. It would appear to me that the Commission could exercise a control over the sale of advisory contracts through requirement of technical knowledge and experience on the part of the purchaser without resorting to the strained fiduciary relationship theory.

In the particular company about which I talked with you, the President is 82 years of age and a Vice President 79. It is inevitable, then, that by

reason of age, within the next few years, substantial blocks of the stock of the sponsor company must and will be sold. Their Trust Agreement imposes strict limitations upon the investment adviser and upon the compensation which the management company may receive, and it does not appear to me that there could be any actual abuse of a trustee relationship resulting from a sale of an interest in such company.

I might also point out the inequity of the situation where a shareholder is entitled to sell a 24% interest at a fair market price and yet be required to sell a 25% or 26% interest for a much smaller price.

I have gone into detail in presenting my thoughts in the matter in order that you might have the benefit of these ideas in the discussion which will take place at the hearing mentioned in your letter.

With thanks for your interest in this subject, and my kindest personal regards,

Sincerely,

/s/ LEE KAISER.

LMK:B

EXHIBIT C

(Copy)

Division of Corporate Regulation.

November 10, 1955.

Mr. Leland M. Kaiser,
Russ Building,
San Francisco 4, California.

Re: Kaiser & Co., File No. 132-3.

Dear Mr. Kaiser:

Reference is made to your letter of October 3, 1955, to Commissioner Orrick in which you set forth your views and comments on the question of assignment of investment advisory contracts.

The problem of the legality of the transfer of investment advisory and underwriting contracts for a consideration was fully considered recently by the Commission and the staff in connection with a proposed agreement to transfer control of an investment management company and the corporate principal underwriter for two registered investment companies. This matter was adverted to in Commissioner Orrick's letter of September 23, 1955.

In arriving at its determination regarding the proposed agreement before it, the Commission followed the principles enunciated in the General Counsel's Opinion of May 11, 1942 (Investment Company Act Release No. 354), to the effect that the receipt of consideration for the purported as-

signment of an investment advisory contract constitutes gross misconduct and gross abuse of trust, subject to Commission action under the provisions of Section 36 of the Investment Company Act. The principles set forth in that Opinion were also considered by the Commission to be applicable to the purported transfer of an underwriting contract for a consideration.

The problems raised by you in your letter are necessarily inherent in the situation and create personal difficulties which merit sympathetic consideration. Nevertheless, any substantive departure from the principles mentioned above would create even greater problems contrary to the interests of investors. That is apparent from the legislative history of the statute and the reason for the provisions of Section 15.

In any event, the Commission appreciates your comments and observations. If you have any further questions, please do not hesitate to communicate with me.

Very truly yours,

/s/ LAWRENCE M. GREENE,
Assistant Director.

EXHIBIT D

Kaiser & Co.
Investment Bankers
Russ Building
San Francisco 4

November 15, 1955.

Leland M. Kaiser,
Edwin R. Foley,
Leslie E. Rowell,
Charles R. Burgess.

Mr. Lawrence M. Greene,
Assistant Director,
Division of Corporate Regulation,
Securities and Exchange Commission,
Washington 25, D. C.

Dear Mr. Greene:

Thank you for your letter in which you outline for me the Commission's recent determination relative to transfer of control of an investment management company and the corporate principal underwriter for two registered investment companies.

I am sorry to have missed seeing you while in Washington recently and hope to have the opportunity to meet you on my next visit to your city.

With kindest personal regards,

Sincerely,

/s/ LEE KAISER,

KAISER & CO.

[Title of District Court and Cause.]

AFFIDAVIT OF CHARLES H. EISENHART

Washington,

District of Columbia—ss.

Charles H. Eisenhart, being duly sworn on his oath according to law, declares and says:

(1) I am an Assistant Director in the Commission's Division of Corporation Finance and have been employed in that capacity since October, 1952. Among my functions is the review of proxy soliciting material filed by certain registered investment companies pursuant to Section 20(a) of the Investment Company Act of 1940 (the Act, 15 U.S.C. 80 A-20(a), and Rule N-20A-1 (17 CFR 270.20a-1). The Trust Fund sponsored by Insurance Securities, Incorporated, filed preliminary proxy material on July 2, 1956, which I reviewed.

(2) When proxy soliciting material is filed by a registered investment company the staff of the Division of Corporation Finance examines such material to determine whether all of the basic information specifically required by Regulation X-14 (17 CFR 204.14), applicable to registered investment companies, has been included in the material and whether in the light of Rule X-14A-9 the material contains misleading statements or omits material facts necessary to make the statements made not misleading in the circumstances. The rules are designed to provide an investor with material in-

formation regarding each separate matter with respect to which his vote or consent is sought.

The Division of Corporate Regulation which is charged with the administration of the regulatory provisions of the Act, reviews the material filed by investment companies to determine whether the matters to be acted upon by security holders are in other respects in compliance with the Act and the Rules and Regulations promulgated thereunder. If, in the course of that Division's examination, it is deemed necessary to make comments or to request additional information for inclusion in the proxy material that Division may advise the investment company directly or request our Division to make such comments or to secure the information from the company.

(3) Since the proxy material of investment companies is reviewed by two divisions of the Commission, it is our practice to co-ordinate the processing by both staffs. If the Division of Corporate Regulation has completed its review it will furnish the Division of Corporation Finance with comments to be included along with the latter Division's comments. It is also our practice to limit our comments to matters pertaining to the functions of the Division of Corporation Finance if the other Division has not completed its review and advise the company that the Division of Corporate Regulation has certain questions which have not been determined or resolved.

(4) In the course of our review of the preliminary proxy material filed by Insurance Securi-

ties, Incorporated, on July 2, 1956, in connection with a special meeting of investors holding Participating Agreements in the Trust Fund to be held on August 15, 1956, I was informed by the staff that the Division of Corporate Regulation was considering certain problems with respect to the question of the transfer and assignments of the Investment Advisory and Underwriting contracts, two matters as to which proxies were proposed to be solicited, and the impact of Section 36 of the Act upon such matters.

(5) I was also informed by the staff that on or about July 10, 1956, an inquiry had been received by telephone from a representative of the company asking when our comments would be furnished. Under Rule X-14A-6 proxy statements are required to be filed at least 10 days prior to the date definitive copies of such material are first sent or given to security holders, or such shorter period prior to that date as the Commission may authorize upon a showing of good cause therefor. The proxy material had been sent by air mail to the Commission on June 29, 1956, and had been received at our office on July 2, 1956. In the letter accompanying the proxy material the company requested that we advise by telegram whether we had any comments and, if so, to forward such comments by air mail.

(6) Having in mind the written request from the company and upon being informed of the telephone request for our comments, I furnished such comments as the Division of Corporation Finance

had at that time and advised the company that certain questions had been raised by our Division of Corporate Regulation which were unresolved. On July 10, 1956, I dispatched a telegram to Mr. R. A. Haight, Secretary of Insurance Securities, Incorporated, as follows: "Proxy Soliciting Material Comments being air mailed today."

(7) On July 10, 1956, I signed the letter of comments which according to our records was air mailed to Mr. Haight on said date.

(8) The aforesaid letter of July 10, 1956, included the following:

"We understand that our Division of Corporate Regulation has raised certain questions regarding the assignment of the Investment Advisory and Underwriting contracts."

The foregoing statement was intended to advise the recipient of the letter that there remained a problem which, as of the date of the communication, remained undetermined and unresolved.

The aforesaid paragraph was not intended to advise, and did not advise, Mr. Haight that no additional comment would be forthcoming or that the inclusion of additional material would not be requested in the event it became apparent that inquiries being made by the Division of Corporate Regulation made such additional comment or request either necessary or appropriate. Responsibility for compliance with the Commission's proxy

rules rests with the issuer rather than with the staff of the Commission.

/s/ CHARLES H. EISENHART.

Subscribed and sworn to before me on this 17th day of October, 1956.

/s/ NEVA M. BRINKLEY,
Notary Public.

My commission expires: 12-1-58.

[Endorsed]: Filed October 24, 1956.

[Title of District Court and Cause.]

SUPPLEMENTARY AFFIDAVIT OF ROY A.
HAIGHT ON BEHALF OF DEFENDANTS

State of California,
County of Alameda—ss.

Roy A. Haight, being first duly sworn, deposes and says:

I am one of the named defendants in the above-entitled cause, and I am now and at all times mentioned have been the Secretary of Insurance Securities, Incorporated, hereafter called I.S.I.

The meeting of investors, referred to in Exhibit B to the complaint herein, was held on August 15, 1956. Proposal No. 1 on the proxy, copy of which is part of said Exhibit B, entitled, "A Proposal to

Provide a Board of Directors to Supervise the Management of the Trust," was adopted by the investors at said meeting and Howard D. Ainsworth, Leland M. Kaiser, Edwin R. Leach, Brayton Wilbur, and Judge A. J. Woolsey were elected as such Directors at such meeting, their terms to begin on the effective date of amendment of the Trust Agreement creating said Board. Proposals 5 and 6 entitled, respectively, "A proposal to reinstate contract as Investment Adviser" and "A proposal to reinstate contract as Principal Underwriter," were not acted upon at that meeting because of this Court's interlocutory order of August 14, 1956, and the meeting was adjourned to September 14, 1956. On the latter date the adjourned meeting of the investors was held, and said proposals 5 and 6 were adopted. Following the vote of the investors adopting said proposals, and on September 17, 1956, the trust agreement by and between I.S.I., Pacific National Bank of San Francisco as trustee, and the investors was amended to reinstate the investment advisory and principal underwriting contract between said trustee, the investors and I.S.I. and to establish a board of trustees referred to as a board of directors of said Trust Fund to supervise its management.

Since September 17, 1956, the directors of said Trust Fund have been Howard D. Ainsworth, Leland M. Kaiser, Edwin R. Leach, Elwood Murphey, Donald B. Rice, Brayton Wilbur and Judge A. J. Woolsey.

Concurrently with their election as directors of the Trust Fund, Edwin R. Leach, Howard Ainsworth, Brayton Wilbur and Judge A. J. Woolsey resigned as directors of I.S.I. Since September 17, 1956, the directors of I.S.I. have been Hon. John J. Allen, Jr., William H. Bowen, Ossian E. Carr, Roy A. Haight, Abe P. Leach, A. J. Lonergan, Elwood Murphey, Donald B. Rice and Leland M. Kaiser.

/s/ ROY A. HAIGHT.

Subscribed and sworn to before me this 12th day of November, 1956.

[Seal] /s/ LEONA L. ALDRIDGE,
Notary Public in and for the County of Alameda,
State of California.

My Commission Expires May 25, 1959.

Receipt of copy acknowledged.

[Endorsed]: Filed November 13, 1956.

[Title of District Court and Cause.]

OPINION ON MOTION TO DISMISS

Goodman, District Judge:

The motion to dismiss the plaintiff's complaint involves the question whether the "Investment Company Act of 1940" (54 Stat. 847; 15 USC 80a, et seq.) invests in the plaintiff the right to obtain the relief here sought. This tenders a problem of first impression.

The plaintiff will be referred to as "SEC," the defendant Insurance Securities, Incorporated, as "Service Company" and the defendant "Trust Fund Sponsored by Insurance Securities, Incorporated," and open-end diversified management company, as "Trust Fund."

The complaint discloses that the Trust Fund is an open-end diversified management company, organized under California law, and authorized by Sections 4 and 5 of the Act 15 (USC 80a—4 and 5) and registered with SEC in accordance with Section 8b of the Act (15 USC 806). The Trust Fund purchases insurance securities and sells to public investors, agreements of participation or interest in the Trust Fund's securities. All securities of Trust Fund are held by Pacific National Bank of San Francisco, as Trustee under a trust agreement between it, and Service Company for the benefit of Trust Fund's investors. The Service Company, a California corporation, is the sponsor and investment advisor and principal underwriter of the Trust Fund. The defendants, Leach, Carr, Loneragan and Haight, are directors and officers and principal stockholders of Service Company. Trust Fund has no officers or directors of its own and its management functions have been carried on by Service Company.¹

¹Since the commencement of the action, Trust Fund has, by amendment to its bylaws, authorized the creation of a Board of Directors of its own.

Service Company sells to the public, investment participating agreements in Trust Fund and receives a fee for such service as well as a fee for administering Trust Fund, and for investment advice in connection with the purchase and sale of its securities. Such an arrangement is sanctioned by the Act.² The relationship of Service Company and Trust Fund is governed by a trust agreement, which specifies the nature of the obligations of Service Company, its compensation and the reciprocal obligation of Trust Fund to pay for such service. The Act requires,³ and the trust agreement provides, that the agreement must be approved annually by a majority vote of the investment participation units of Trust Fund.

The relationship above described started in 1938 and has continued since upon a rising arc of volume until, in 1955, the receipts of Service Company from all fees amounted to \$4,798,000.

In 1956, the four individual defendants named, *supra*, whom SEC alleges had the controlling stock interest in Service Company, sold their shares to a group of newcomers headed by defendant Kaiser. Thereupon, Service Company solicited proxies from the investors in Trust Fund to be voted at a meeting of the investors in Trust Fund for the purpose of reaffirming the existing agreement between Service Company and Trust Fund, for the amendment

²Sec. 15 of the Act; 15 USC 80a-15.

³Sec. 15 of the Act; 15 USC 80a-15b-1.

of the bylaws of Trust Fund to provide for the establishment of a board of directors thereof, and for the election of the individually named defendants as directors of Trust Fund.

SEC sought by the complaint to enjoin the holding of the meeting, to enjoin the individually named defendants (except Kaiser)⁴ from holding office as directors of Trust Fund, to perpetually debar them from thereafter holding office as directors of Service Company, to enjoin the proposed reinstatement of the contracts between Service Company and Trust Fund, and further that the individually-named defendants be required to account for the profits realized upon the sale of their shares in Service Company, alleged to be approximately \$4,240,000 in excess of the net book value of such shares.

SEC claims that the right to this remedy flows from Section 36 of the Act (15 USC 80a—35), in that the officers and directors of Service Company have been guilty of “gross misconduct or gross abuse of trust in respect of the registered investment company for which (they) act.”⁵

⁴Dismissal of the action against defendant Kaiser is separately sought upon the ground that no cause of action is stated against him and that it does not appear that he is a necessary or proper party. We do not discuss this aspect of the motion in view of the disposition made of the whole case.

⁵Sec. 36. The Commission is authorized to bring an action in the proper district court of the United

SEC contends that the sale by the individually named defendants of a claimed controlling interest in Service Company shares, worked an automatic termination of the contracts between Service Company and Trust Fund. If the sale of the shares by the individually named defendants was a sale of a controlling interest, the SEC is right, for Sec. 15 (a)(4) of the Act provides that any assignment of such contracts automatically terminates the same and Sec. 2(a)(4) of the Act provides that the sale or transfer of a controlling block of the outstanding voting securities of a Service Company is an assignment within the meaning of Section 15(a)(4).

The Court finds it unnecessary to decide the question whether under the complaint's allegations, the

States or United States court of any Territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has been guilty, after the enactment of this title and within five years of the commencement of the action, of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts:

(1) As officer, director, member of an advisory board, investment advisor, or depositor; or

(2) As principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If the Commission's allegations of such gross misconduct or gross abuse of trust are established, the court shall enjoin such person from acting in such capacity or capacities permanently or for such period of time as it in its discretion shall deem appropriate.

sale by the four named individual defendants was a transfer of a controlling stock interest in Service Company, inasmuch as decision on the motion to dismiss will be based upon the fundamental issue as to whether the statute otherwise authorizes this cause or the remedy sought.

The language of Section 36 is clear. The Congress authorized the sort of action here brought if officers or directors of an investment advisor are guilty of gross misconduct or gross abuse of trust in respect of any registered investment company for which such persons serve or act. The complaint makes no charge of any misconduct or abuse of trust, gross or otherwise, with respect to Trust Fund or its investors. No claim has been made in the complaint or otherwise that the business of Trust Fund has not been conducted efficiently or honestly or that the investors of Trust Fund have suffered any loss or damage of any kind with respect to their interest in Trust Fund by reason of any act or conduct of Service Company, or its officers or directors.

In my opinion, no dereliction or even misconduct of officers or directors of Service Company within the area of its own independent affairs falls within the reach of Section 36.⁶ That the Congress clearly

⁶The second cause of action alleges misstatements or omissions in the proxy statements distributed by Service Company to the investors of Trust Fund. Such allegations, if proved, might be violative of other sections of the Act (20a of the Act) and of

intended to so limit the reach of Section 36, as it clearly did in precise language, is evidenced by the fact that Section 36, when first considered by the Congress, applied to misconduct and abuse of trust generally.⁷

But the Congress decided to limit, as it did in the Act itself, such misconduct to obligations respecting the Trust Fund itself.⁸

In its essence, the contention of SEC appears to be that, per se, the assignment or sale at substantial profit, of a controlling stock interest in Service Company, since it works an automatic termination of the trust agreement, injured the trustors of Trust Fund and constituted "gross misconduct" or "gross abuse of trust under Section 36. But there is no warrant for such a non sequitur. The Congress did not make the assignment of agreements between Service Company and Trust Fund, a violation of the Act, thus subjecting the violator to any or all of the sanctions provided by the Act. The Congress

the Regulations, authorized by the Act (Rule N-20A-1; 17 C.F.R. 270.20a-1) but are not reachable under Section 36.

⁷See original bill introduced in the Senate by Senator Wagner, March 14, 1940 (S. 3580, 76th Cong., 3rd Sess.).

⁸See *Doyle v. Milton*, 73 Fed. Supp. 281 at 284, 285; *idem. Addison v. Holly Hill Co.*, 322 U.S. 607, 617.

provided a specific remedy, namely, that any such assignment worked an automatic termination, thus leaving it to the investors of Trust Fund to determine whether or not they wanted to continue on under a similar or different agreement with Service Company, differently controlled by different stock ownership therein, or contract with some other service company.

It is argued by SEC that there is something evil, amounting to gross misconduct or abuse of trust on the part of the principal owners of Service Company, arising out of the large profit in the sale of their shares and in soliciting and obtaining proxies from the investors of Trust Fund for the purpose of reinstatement of the terminated contract and thus making secure and certain the large profits referred to. And SEC says that these profits are trust funds for which the principal owners of Service Company are accountable to the investors of Trust Fund.

This argument is reminiscent of what has often been stated in many cases, where it is sought to judicially extend the purposes and reach of statutes, namely, that such arguments should be directed to the Congress. It may be, but the Court stands aloof from this consideration, that statutory provisions might or should be made with respect to such matters. The courts are not over-all supervisory agents of all the morals, equities or standards in the field regulated by the Act. We have enough to do to

apply and interpret the statutes as the Congress writes them.⁹

While the complaint sets forth two causes of action, it is clear, and indeed it is admitted, that the second cause of action stands or falls upon the validity of the first. Consequently, it is unnecessary to discuss the second cause of action.

The motion to dismiss the complaint is granted.

Present an order accordingly.

Dated November 29, 1956.

[Endorsed]: Filed November 29, 1956.

⁹The only case cited by SEC involving the application of Sec. 36 (and indeed the only case we have been able to find) is *Aldred Investment Trust vs. SEC*, 151 Fed. 2d 254, Cir. 1, 1945). It has no precedential value here because it involved a clear breach of trust as to the trust fund. There the Operator of the trust fund clearly abused his trust by converting good utility securities into ownership of a race track!

United States District Court for the Southern
District of California, Southern Division

Civil Action No. 35764

SECURITIES AND EXCHANGE COMMIS-
SION,

Plaintiff,

vs.

INSURANCE SECURITIES INCORPORATED,
TRUST FUND SPONSORED BY INSUR-
ANCE SECURITIES INCORPORATED,
ABE P. LEACH, OSSIAN E. CARR, AR-
THUR J. LONERGAN, ROY A. HAIGHT,
and LELAND M. KAISER as Attorney, and
Proxy for Investors of Trust Fund,

Defendants.

ORDER DISMISSING
AMENDED COMPLAINT

The defendants having filed a motion to dismiss the amended complaint for failure to state a claim for which relief can be granted, the plaintiff, having filed an answer thereto, and the parties having filed written briefs; and this Court having heard oral argument on November 16, 1956, and having considered said motion and answer thereto,

It Is Hereby Ordered, Adjudged and Decreed that said motion be, and it hereby is granted, and the amended complaint is hereby dismissed with

prejudice, as to each and every defendant named above.

It Is Hereby Further Ordered that the Court's Second Interlocutory Order of August 30, 1956, be and the same is hereby dissolved.

Dated December 4th, 1956.

/s/ LOUIS E. GOODMAN,
United States District Judge.

Approved as to form under Local Rule 21.

THOMAS G. MEEKER,
AARON LEVY,
F. E. KENNAMER, JR.,

By /s/ AARON LEVY,
Attorneys for Plaintiff.

[Endorsed]: Filed December 4, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that the Securities and Exchange Commission, plaintiff in the above-entitled action, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the order of the District Court, entered on December 4, 1956, dismissing the amended complaint in this action and

dissolving the Second Interlocutory Order of August 30, 1956.

/s/ THOMAS G. MEEKER,
General Counsel;

/s/ AARON LEVY,
Special Counsel, Securities and Exchange Commission,
Washington 25, D. C.;

/s/ F. E. KENNAMER, JR.,
Attorney, Securities and Exchange Commission,
821 Market Street, San Francisco, California.

January 22, 1957.

[Endorsed]: Filed January 24, 1957.

[Title of District Court and Cause.]

DESIGNATION OF RECORD TO BE TRANSMITTED TO THE COURT OF APPEALS

The Clerk will please transmit to the United States Court of Appeals for the Ninth Circuit the following documents as the record on appeal in this case:

1. Complaint and exhibits thereto, filed August 13, 1956.
2. Amendment to Complaint, filed August 13, 1956.
3. Interlocutory Order, dated August 14, 1956.

4. Defendants' Notice of Motion to Dismiss and to Dissolve, including the nine affidavits attached thereto, dated August 24, 1956.

5. Second Interlocutory Order, dated August 30, 1956.

6. Answer of SEC in Opposition to Defendants' Motions to Dismiss and for Summary Judgment, including affidavits and exhibits attached thereto, dated October 23, 1956.

7. Supplementary Affidavit of Roy A. Haight, verified November 12, 1956.

8. Opinion of Judge Goodman Granting Motion to Dismiss Complaint, dated November 29, 1956.

9. Order of Judge Goodman, dated December 4, 1956, Dismissing Amended Complaint, etc.

10. Notice of Appeal, filed January 24, 1957.

11. This designation.

/s/ THOMAS G. MEEKER,
General Counsel;

/s/ AARON LEVY,
Special Counsel, Securities and Exchange Commis-
sion, Washington 25, D. C.;

/s/ F. E. KENNAMER, JR.,
Attorney, Securities and Exchange Commission,
821 Market Street, San Francisco, California.

Dated January 29, 1957.

The United States District Court, Northern District
of California, Southern Division

No. 35764

SECURITIES AND EXCHANGE COMMIS-
SION,

Plaintiff,

vs.

INSURANCE SECURITIES, INC., et al.,

Defendants.

REPORTER'S TRANSCRIPT
HEARING ON MOTION TO DISMISS

Friday, November 16, 1956.

Before: Hon. Louis E. Goodman, Judge.

Appearances:

For SEC:

F. E. KENNAMER, ESQ.,
AARON LEVY, ESQ.

For Defendants:

MOSES LASKY, ESQ.,
PHILIP S. EHRLICH, ESQ.,
ELWOOD MURPHEY, ESQ.,
ALFRED JARETZKI, JR., ESQ.

The Clerk: Securities and Exchange Commission
versus Insurance Securities, Inc., motion to dismiss.

Will respective counsel please state their appearances for the record?

Mr. Lasky: For the moving defendants, Moses Lasky, Philip S. Ehrlich, Elwood Murphey and Alfred Jaretzki, Jr.

Mr. Levy: For the plaintiff, Mr. Thomas G. Meeker, Aaron Levy and F. E. Kennamer.

Mr. Lasky: If the Court pleases, the motion before the Court this morning is a motion to dismiss the complaint. In the old terminology it is a demurrer. We accept all the allegations in the complaint, although we certainly don't accept the conclusions of law, with which this complaint is replete. We take the allegations of fact and we submit that the complaint doesn't state a claim for relief.

Now, the reason I make that statement at the outset is that a considerable mass of affidavits will be found in the files; the defendants filed, I think, nine, and the plaintiffs have filed a number. The major reason why those affidavits appear in the file is that when this case started, the plaintiff, Securities and Exchange Commission, came into court ex parte and applied for certain interlocutory injunctions, and there was a hearing scheduled, and our affidavits were primarily filed in opposition. In our motion to dismiss, which we promptly filed, stated that we might rely upon those affidavits, and, of course, to the extent that we would do so, it would have [2*] to be treated as a motion for summary judgment. We had in mind at the time that there

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

were many uncontradicted objective facts; it didn't rest in the sole knowledge of any particular person, it didn't rest in a state of mind, facts which couldn't be denied and which might help to clarify. And it may be that before I finish my argument, I may refer to some of those uncontradicted objective facts.

But primarily this is a motion to dismiss. We think the issues presented by this case are purely issues of law, and I hope before I finish my presentation that your Honor will agree with our view, that the plaintiff's foundation and basic contention is about as fantastic an assertion as has ever been presented in a court. [3]

* * *

The Court: What your argument really comes down to, Mr. Lasky, is not that it requires an interpretation in the sense that you have just made it, of the provisions of the statute, but that you would first have to have an act that [39] affects the trust fund before you apply the provisions of this section.

Mr. Lasky: Yes, that is quite true; and I can word it this way. We are here talking about technical language of an act. I say the technical language of the act was never intended to cover these people in the respect of selling stock, because there wasn't any reason to.

The Court: You base that argument on the subject matter to which their acts appertain, rather than the fact that if there was an act of gross misconduct which related to the trust fund, and it was

committed by a director or officer of I.S.I., it wouldn't be reachable under this statute? [40]

* * *

The Court: If it were determined that the act that is alleged to have been committed that constituted the gross misconduct did apply to the properties of the trust fund, then I wouldn't have much difficulty in determining this statute is applicable. I think that would be a fair statement, wouldn't it?

Mr. Lasky: All right, I think that may be a fair statement. I say that neither the purposes of the statute or the specific language of the statute ever had in mind this kind of conduct, and therefore, you would have to be a little liberal with the interpretation to make it apply to the type of conduct that the act wasn't concerned with at all. [41]

* * *

So let me get back, then, to Count 1. And I want to refer at this point to the affidavits. I still take the fundamental position that taking Count 1 just on its face, accepting all its allegations of fact, it doesn't state a claim for relief. Plaintiff does not contend that there is gross abuse or any kind of abuse in the sale of the stockholder stock to outsiders in I.S.I., regardless of price, unless there has been a controlling block sold. Now, how plaintiff works in the element of controlling block as a factor in his reasoning, I am not wholly sure. But he has it there; it is an element of his case.

The Court: Wouldn't that be a factual question?

Mr. Lasky: Oh, yes, in part; and I assure your

Honor, I don't intend to ask your Honor to decide any factual questions [46] upon affidavits. But there are certain uncontradicted objective facts, and I think I can bring this to a head very quickly. The uncontradicted facts are that not a single one of these stockholders owned as much as a controlling block. The statute defines a controlling block as 25 per cent of the stock. Not a single stockholder in I.S.I. owned as much as a controlling block. There were sales in February, there were sales in May, there was one in July and September. Not a single one sold all he had to any one buyer. And if you added up everything that each seller had, he didn't have a controlling block to sell.

So the plaintiff has tried to make up for this deficiency by its allegation in Paragraph 16 of its complaint. Paragraph 16 of the complaint starts off that:

“Upon information and belief, on or about February 1st, 1956, the director defendants either alone or in concert with others embarked upon a plan to sell their stock interests to a small number of purchasers affiliated among each other through stock ownership or otherwise.” [47]

* * *

Mr. Lasky: * * * So the Plaintiff seeks to meet that with his allegation of Paragraph 16, that the plan was to sell to a small number of purchasers affiliated among each other through stock ownership or otherwise. Now, the affidavits show how many

buyers there were. I have only noted four here. I think there were seven altogether. The affidavit shows that three of the buyers were affiliated. They were what we call the "Life group." There isn't any doubt about that. And that "Life group" got 14 and a fraction per cent of the stock—which is not a control. It is not a controlling block. The affidavits show who the other buyers were. They were a series of individuals. And the affidavits of the buyers—and I am not going to refer to the affidavit of Mr. Kaiser, who was the intermediary here, I am just taking that of the buyers, who are not [48] defendants in the case—state that they are not affiliated with each other. Now, it is obvious that they are not affiliated by stock. And so this allegation of the complaint that the buyers were affiliated with each other through stock ownership is an objective fact which is shown to be untrue.

* * *

The Court: I don't see how you can reach that question on a motion to dismiss, though, because it may be that one side would say, "Well, I am not bound by the affidavit of the man who says he didn't act. Maybe I can prove it otherwise—that he didn't act in concert with someone else." It is a very difficult thing to reach that sort of a question on a motion to dismiss or even on motion for summary judgment.

Mr. Lasky: Certainly not on a straight motion to dismiss. And I have accepted counsel's contention that you couldn't act upon the affidavit of a defend-

ant, and so I am ignoring all those affidavits. I merely say that here we had these buyers, who are not defendants in the case, and when each [49] one files an affidavit and says, "Well, I had no agreement with the other buyers," that is an objective fact. However, if your Honor feels that that's an issue that we can't get into at this time, I say again, I don't want to get this case at this time fouled up in procedural dots. And so we will just come back, and I will submit the matter upon the assumption of the complaint that we had a controlling block of stock sold by a group to another group affiliated.

But there is one set of facts in the affidavits which your Honor can act on, because it doesn't depend upon anybody's state of mind and doesn't depend upon anybody's oral testimony. [50]

* * *

Mr. Levy: * * * Now that brings me, then, to the question of the second cause of action. Now, as I said before, the second cause of action is tied in with the first cause of action. If there is a gross abuse of trust and the directors are subject to the sanctions under Section 36, then we say that the proxy statement was false and misleading in several respects. [114]

* * *

The Court: You don't set that up, though, as an independent cause of action.

Mr. Levy: No; your Honor, I do not. But what I say is this, that if there is a section 36, then I say in the light of Section 36, the proxy statement

is incomplete and false and misleading in several respects. While it is true that conceivably the Commission could have said and might have said in a particular case that these matters should have been disclosed regardless of what the consequences of the transaction are with respect to 36, we do not choose in this case to allege it that way, merely as a matter of discretion, as to what the Commission wants to charge here.

The Court: Well, if it were held that this was not an act of gross misconduct in making this transaction, then the statement of the circumstances in the proxy statement would become immaterial? Or would it still be material?

Mr. Levy: Well, as we reframed this complaint, your Honor, the two must stand together or fall together, that is correct.

* * *

[Endorsed]: Filed February 4, 1957. [117]

[Title of District Court and Cause.]

EXCERPT FROM DOCKET ENTRIES

1956

Aug. 13—Filed complaint—no summons at request of attorney.

* * *

Aug. 13—Filed amended complaint.

1956

Aug. 13—Ordered after ex parte hearing motion for restraining order and preliminary injunction continued to Aug. 14, 1956, at 11:00 a.m. (Goodman.)

Aug. 14—Ordered after hearing interlocutory order entered on stipulation of counsel and application for preliminary injunction continued to Sept. 7, 1956. (Goodman.)

Aug. 14—3:30 p.m. filed interlocutory order vs. defendants from voting proxies received from voters with respect to proposed reinstatement of Investment Advisory Contract; proposed reinstatement of Principal Underwriting Contract and Election of Abe P. Leach and Roy A. Haight as members of board of directors pending further order of Court. Application for preliminary injunction continued to Sept. 7, 1956, at 10:00 a.m., all without prejudice to any other relief to which parties may be entitled. (Goodman.)

Aug. 15—Filed stip. and order extending time for defts. to plead to Aug. 24, 1956, and plttf. to Sept. 5, 1956, to serve responsive pleadings. Defts. 30 days following order of Court on motion for preliminary injunction to plead to complaint. (Goodman.)

* * *

Aug. 21—Filed request of defendants for admissions by plaintiff.

1956

Aug. 24—Filed notice by Ins. Sec. Inc., Leach, Carr, Lonergan, Haight and Kaiser of motion to dismiss, Sept. 7, 1956.

Aug. 24—Filed affidavit of Leland M. Kaiser, Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight, D. D. Harrington, John D. Murchison, S. W. Richardson, Perry R. Bass in support of motion to dismiss.

* * *

Aug. 29—Filed answer of plaintiff to request for admissions.

Aug. 30—11:30 a.m. filed second interlocutory order withdrawing order of Aug. 14, 1956, subject to following conditions: pending final determination proxies of investors shall not be voted; Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan and Roy A. Haight shall not serve as directors of Trust Fund pending final determination; dividends on any stock owned by said defendants shall be segregated and withheld by Ins. Sec. Inc.; said defendants shall not sell their remaining stock in Ins. Sec. Inc., all without prejudice to jurisdiction of Court to grant any and all relief. Motion of deft. to dismiss continued to Nov. 2, 1956, at 10:00 a.m. (Goodman.)

Oct. 1—Ordered, motion to dismiss Cont'd to Nov. 16, 1956. (Goodman.)

1956

Oct. 24—Filed answer of SEC in opposition to motion of defendants to dismiss and for summary judgment.

Oct. 29—Filed interrogatories by defendants to plaintiff.

* * *

Nov. 8—Filed notice by plaintiff of taking deposition of Leland M. Kaiser.

Nov. 9—Filed notice by defendants of motion to defer deposition, Nov. 13, 1956, with order shortening time for service. (Goodman.)

Nov. 9—Ordered motion to defer taking deposition assigned for hearing Nov. 13, 1956, at 9:30 a.m. (Goodman.)

* * *

Nov. 13—Ordered after hearing, motion to defer taking depositions continued to Nov. 19, 1956. (Goodman.)

Nov. 13—Filed answer of SEC to interros. by deft.

Nov. 16—Hearing on motion to dismiss and to defer taking depositions. Arguments heard and motion to dismiss submitted. Motion to defer taking depositions continued until further order of Court. (Goodman.)

Nov. 29—Filed opinion of Court on motion to dismiss (motion of deft. granted). Counsel to prepare order accordingly. (Goodman.)

* * *

Dec. 4—Filed order dismissing amended complaint with prejudice. (Goodman.)

1957

Jan. 24—Filed notice of appeal by plaintiff.

* * *

Jan. 31—Filed appellant's designation of record on appeal.

Feb. 1—Filed appellee's designation of record on appeal.

* * *

Feb. 4—Filed reporter's transcript of proceedings
Nov. 16, 1956.

* * *

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, hereby certify the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and constitute the record on appeal herein as designated by the Attorneys for appellant and appellees:

Excerpt from Docket Entries.

Complaint.

Amendment to Complaint.

Interlocutory Order.

Request by Defendants for Admissions of Fact.

Notice and Motion by Defendants to Dismiss and to Dissolve, with nine Supporting Affidavits.

Reply of Plaintiff to Defendants' Request for Admissions of Fact.

Minute Order of October 1, 1956.

Second Interlocutory Order.

Answer of Plaintiff in Opposition to Defendants' Motion to Dismiss and for Summary Judgment.

Supplementary Affidavit of Roy A. Haight on Behalf of Defendants.

Minute Order of November 16, 1956.

Opinion of the Court on Motion to Dismiss.

Order Dismissing Amended Complaint.

Notice of Appeal by Plaintiff.

Appellant's Designation of Record on Appeal.

Appellees' Designation of Record on Appeal.

Reporter's Transcript of Proceedings of November 16, 1956.

In Witness Whereof I have hereunto set my hand and affixed the seal of said District Court this 28th day of February, 1957.

[Seal]

C. W. CALBREATH,

Clerk;

By /s/ MARGARET BLAIR,

Deputy Clerk.

[Endorsed]: No. 15457. United States Court of Appeals for the Ninth Circuit. Securities and Exchange Commission, Appellant, vs. Insurance Securities Incorporated, Trust Fund Sponsored by Insurance Securities Incorporated, Abe P. Leach, Ossian E. Carr, Arthur J. Lonergan, Roy A. Haight and Leland M. Kaiser, as Attorney and Proxy for Investors of Trust Fund, Appellees. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed February 28, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 15457

SECURITIES AND EXCHANGE COMMIS-
SION,

Appellant,

vs.

INSURANCE SECURITIES INCORPORATED,
TRUST FUND SPONSORED BY INSUR-
ANCE SECURITIES, INCORPORATED,
ABE P. LEACH, OSSIAN E. CARR, AR-
THUR J. LONERGAN, ROY A. HAIGHT
and LELAND M. KAISER as Attorney, and
Proxy for Investors of Trust Fund,

Appellees.

APPELLANT'S STATEMENT OF POINTS

I.

Pursuant to Rule 17 (6) of the Rules of this Court, the Securities and Exchange Commission, appellant herein, hereby designates the following as a statement of points on which it intends to rely:

1. The District Court erred in dismissing the amended complaint for failure to state a cause of action under Section 36 of the Investment Company Act of 1940 ("the Act").

2. The District Court erred in determining that the sale of a controlling stock interest in Insurance

Securities Incorporated, on the facts and circumstances herein involved, does not constitute gross misconduct or gross abuse of trust under Section 36 of the Act.

3. The District Court erred in determining that the sale of a controlling stock interest in Insurance Securities Incorporated, on the facts and circumstances herein involved, does not constitute gross misconduct or gross abuse of trust under Section 36 of the Act, "in respect of" the Trust Fund, a registered investment company.

4. The District Court erred in determining that the sale of a controlling stock interest in Insurance Securities Incorporated, on the facts and circumstances here involved, does not contravene the statutory policies as set forth in Section 15 and other sections of the Act, and the obligations which the defendants, as fiduciaries, owed to the Trust Fund.

5. The District Court erred in determining that the statutory provisions regarding the termination of the principal underwriting and investment advisory contracts between the Trust Fund and Insurance Securities Incorporated constitute a limitation upon the scope and reach of Section 36 of the Act and applicable equitable principles.

6. The District Court erred in not deciding that Insurance Securities Incorporated and the individual defendants named in the complaint are persons within the reach of Section 36 of the Act.

7. The District Court erred in not deciding that the amended complaint herein states a cause of ac-

tion under Rule X-14A-9 of the Proxy Rules promulgated by the Securities and Exchange Commission and applicable to proxy solicitations with respect to the Trust Fund, a registered investment company.

/s/ THOMAS G. MEEKER,
General Counsel;

/s/ AARON LEVY, O.E.P.
Special Counsel;

/s/ F. E. KENNAMER, JR.,
Attorney, Securities and
Exchange Commission.

Dated: February 28, 1957.

[Endorsed]: Filed March 1, 1957.

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United States
COURT OF APPEALS
for the Ninth Circuit

L. H. PIERCE, Appellant

v.

UNITED STATES OF AMERICA, Appellee

UNITED STATES OF AMERICA, Appellant

v.

LENA L. PIERCE, Appellee

BRIEF FOR L. H. PIERCE AND LENA L. PIERCE

*On Appeals from the Judgments of the United States
District Court for the District of Oregon*

FILED

AUG - 3 1957

MORRIS J. GALEN,
JACOB, JONES & BROWN,
522 Public Service Building,
Portland 4, Oregon,

PAUL P. O'BRIEN, CLERK

Of Attorneys for L. H. Pierce and Lena L. Pierce.



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No. 15,461

United States
COURT OF APPEALS
for the Ninth Circuit

L. H. PIERCE, Appellant

v.

UNITED STATES OF AMERICA, Appellee

No. 15,462

UNITED STATES OF AMERICA, Appellant

v.

LENA L. PIERCE, Appellee

BRIEF FOR L. H. PIERCE AND LENA L. PIERCE

*On Appeals from the Judgments of the United States
District Court for the District of Oregon*

The District Court rendered no opinion. Its Findings of Fact and Conclusions of Law are to be found at R. 25-31.

JURISDICTION

These consolidated appeals involve federal income taxes. L. H. Pierce and Lena L. Pierce, the taxpayers,

are husband and wife. The taxes in dispute for the taxable year 1946 were returned and paid on or about March 15, 1947 (R. 17-18). On or about June 7, 1949, L. H. Pierce and Lena L. Pierce each filed claim for refund of the sum of \$1,553.55 (R. 20-21). No decision was rendered by the Commissioner of Internal Revenue within six months after the said claims were filed nor at any date thereafter (R. 20-21).

Within the time provided in Section 3772 of the Internal Revenue Code of 1939, and on December 6, 1954, L. H. Pierce and Lena L. Pierce brought actions in the District Court of the United States for the District of Oregon for the recovery of the taxes paid (R. 3). Jurisdiction was conferred on the District Court by 28 U.S.C. Section 1346.

On October 29, 1956, judgments were respectively entered in the case of L. H. Pierce in favor of the United States of America, dismissing the Complaint, and in the case of Lena L. Pierce in her favor in the amount of \$1,553.55 with interest (R. 31-33).

Within sixty days and on December 5, 1956, notices of appeal were filed by the Government and L. H. Pierce from the judgments respectively adverse to each (R. 34-35). On December 5, 1956, L. H. Pierce filed a cost bond on appeal (R. 35).

QUESTIONS PRESENTED

1. Whether, within the meaning of Section 122(d)(5) of the Internal Revenue Code of 1939, in determining the net operating loss carryback to which a taxpayer is

entitled, deductions not attributable to the particular trade or business in which an operating loss is sustained are allowed to the extent of the gross income of the taxpayer not derived from such trade or business.

2. Whether, within the meaning of Section 122(d) (5) of the Internal Revenue Code of 1939, the trade or business regularly carried on by a taxpayer constitutes, in a community property state, a trade or business of the spouse of the taxpayer for the purposes of computing the net operating loss deduction available to such spouse?

STATEMENT

Findings of Fact in the cases (R. 25-29) were based on stipulated facts contained in the Pre-trial order (R. 14-24), where both actions were consolidated for trial (R. 15).

The taxpayers, L. H. Pierce and Lena L. Pierce, are husband and wife who filed separate individual income tax returns for the years in question, 1946 and 1948. Taxpayers were residents of Multnomah County, Oregon, and in accordance with the community property law of that state each taxpayer reported one-half of the salary income of L. H. Pierce as his or her individual share of the community property (R. 25-26, 28).

Both taxpayers kept their books and filed their returns on a calendar year and cash receipts and disbursement basis. For the taxable year 1946 the taxpayer husband had gross income of \$66,662.26 and net income of \$65,790.16. For the same year the taxpayer wife had gross

income of \$66,662.25 and net income of \$65,825.45. Both taxpayers filed their separate 1946 returns with the Collector of Internal Revenue, Portland, Oregon, on or about March 15, 1947, showing a tax liability in the amount of \$36,456.66 for the husband and \$36,112.31 for the wife which each paid to the Collector (R. 26-27).

The taxpayers were equal partners in the L. H. Pierce Auto Service which was organized on January 1, 1935. Taxpayers shared profits and losses equally for taxable years 1935 through 1948, inclusive. Taxpayers each owned 50% of the issued and outstanding stock of the Pierce Trailer & Equipment Co., an Oregon corporation, organized on or about April 2, 1947. The partnership had engaged in the manufacture of trailers until the corporation was organized, at which time the latter conducted the trailer business. The partnership then leased property it owned to the corporation and conducted other operations not connected with the business of the corporation (R. 27-28).

For the taxable year 1948 the taxpayers had income and losses as follows: The partnership, L. H. Pierce Auto Service, sustained a net operating loss of \$4,193.12. As a result of such net operating loss, each of the taxpayers sustained an operating loss of \$2,096.56, which was reported by each taxpayer on his or her separate 1948 federal income tax return. The corporation, Pierce Trailer & Equipment Co., paid the taxpayer husband \$6,000.00 for his services as president, which was reported, under the community property law, as \$3,000.00 on the separate 1948 federal income tax return by each taxpayer. Each taxpayer sustained a nonbusiness casu-

alty loss and deducted \$3,391.47 on his or her separate 1948 tax return on account of such loss (R. 28-29).

On June 7, 1949, each taxpayer filed a separate claim for refund of taxes paid in 1946 in the amount of \$1,553.55 with the Collector of Internal Revenue, Portland, Oregon. The claims were based upon an alleged overpayment in 1946 assertedly due to a net operating loss carryback from 1948 in the amount of \$2,096.56 in each case resulting from the operation of the partnership (R. 29). The court below concluded that the taxpayer wife was entitled to the carryback and relief in the full amount of her claim, and that the taxpayer husband was not entitled to the carryback and any relief upon his claim (R. 29-31). Judgments were rendered accordingly (R. 31-33), and these appeals followed.

STATEMENT OF POINTS TO BE URGED

The points to be urged by L. H. Pierce in his appeal from the judgment in favor of the United States of America are as follows:

1. The District Court erred in holding that the salary received by L. H. Pierce as president of Pierce Trailer & Equipment Co. must, in the computation of the net operating loss deduction under Section 122 of the Internal Revenue Code of 1939, be offset against the net operating loss sustained by him as a partner of L.H. Pierce Auto Service.

2. The District Court erred in holding that L. H. Pierce was not entitled to any net operation loss deduc-

tion for the year 1946 under the provisions of Section 23(a) of the Internal Revenue Code of 1939.

3. The District Court erred in dismissing the Complaint of L. H. Pierce.

ARGUMENT

I.

In Determining the Net Operating Loss Carryback to Which a Taxpayer Is Entitled, Deductions not Attributable to the Particular Trade or Business in Which the Taxpayer Sustained an Operating Loss Are Allowed to the Extent of Gross Income of the Taxpayer not Derived from Such Trade or Business.

The issue presented is not the definition of the term "trade or business" as used in the net operating loss provisions of the Internal Revenue Code of 1939. That definition is only conclusive if the Court were to hold that salary income is not income from "trade or business," in which event taxpayers would be entitled to judgment in each case. While there is ample authority¹ to justify such a holding and judgment, taxpayers are entitled to judgment in each case even should this court hold that the salary of L. H. Pierce was attributable to a "trade or business" regularly carried on by him.

Taxpayers' contention is that they are not required by Section 122(d)(5) to combine the "profits" of the

¹*McGinn v. Commissioner*, 76 F. 2d 680 (9th Cir. 1935); *Hughes v. Commissioner*, 38 F. 2d 755 (10th Cir. 1930); *Cunningham v. Commissioner*, 20 T.C. 65 (1953); *Luton v. Commissioner*, 18 T.C. 1153 (1952); *Montgomery v. Commissioner*, 17 B.T.A. 1308 (1929).

alleged business of L. H. Pierce with the operating loss of the partnership business conducted by the taxpayers in arriving at the net operating loss carryback. The net operating loss deduction claimed by the taxpayers for 1946 stems from the operating loss of the partnership. Nothing in Section 122 defines the net operating loss deduction as the combined net operating loss resulting from all the business operations of the taxpayer or requires that the profits and losses of each business be combined before making the adjustments set forth in Section 122(d)(5).

An examination of the language and of the history of the net operating loss provisions leaves no doubt that taxpayers in computing their net operating loss carryback may offset against income not derived from the particular business in which the loss was incurred their deductions not attributable to the operation of such trade or business. The net operating loss deduction is intended to prevent a business with erratic earnings from being penalized by the payment of taxes in the years in which it operates at a profit without the benefit of any offsetting deductions for the years in which it operates at a loss. The exceptions and limitations provided in Section 122(d) are for the purpose of insuring that only an economic loss will be taken into account. See S. Rep. No. 648, 76th Cong. 1st Sess., p. 1 (1939-2 Cum. Bull. 524); H. Rep. No. 855, 76th Cong. 1st Sess., p. 9 (1939-2 Cum. Bull. 504, 510).

There is no dispute that each of the taxpayers in the instant case sustained a net operating loss of \$2,096.56 in 1948 (R. 28). Unless effected by the provisions of

Section 122(d)(5), this net operating loss carries back to 1946 and becomes a net operating loss deduction available to each of the taxpayers.

The pertinent provisions of section 122 are as follows:

“(a). Definition of Net Operating Loss. — As used in this section, the term ‘net operating loss’ means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

“(b) . . .

“(1) . . .

“(A) . . . If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years. . . .

* * *

“(d) . . .

“(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall . . . be allowed only to the extent of the amount of the gross income not derived from such trade or business”

The net operating loss deduction thus is the net operating loss carryback reduced by certain adjustments intended to prevent net losses from being used as a deduction by the taxpayer who has not suffered any economic loss by reason of the fact that his income contains non-taxable items (as in the case of percentage depletion and exempt interest), long term capital gains or by reason of the fact that the taxpayer's nonbusiness deductions exceed his income not derived from the business in which the loss was incurred.

Had Congress intended that a taxpayer combine all of his trade or business activities for purposes of determining the net operating loss, it could have accomplished this result with a very slight change in the language of Section 122(d)(5). The mere substitution of the word "a" for the word "such" would have changed the meaning of the section so as to encompass all business activities of a taxpayer. The use of the word "such" must clearly have been intended to limit the application of Section 122(d)(5) so as to preclude a taxpayer from increasing the amount of his net operating loss by the amount of his nonbusiness deductions.

An examination of Section 122 shows that Congress intended the term "such trade or business" to relate to the trade or business of the taxpayer in which the net operating loss was sustained. To read into the statute the word "a" in place of the word "such" is to impose a limitation not intended by Congress. Each business activity must stand by itself and a net operating loss shall be diminished only by the amount that the taxpayers' other income exceeds the taxpayers' other deductions. Any other interpretation would distort the statute and work on the taxpayers in the instant case a hardship not intended by Congress.

Both *Folker v. Johnson*, 230 F. 2d 906 (2d Cir. 1956), and *Overly v. Commissioner*, 1957 P-H Par. 72,677 (3d Cir., decided April 29, 1957), were decided upon the question of whether an executive's services as such constituted engaging in a trade or business. The court in neither case discussed or apparently considered whether a taxpayer was required to combine the income from

all business activities in order to determine the net operating loss carryback which he claimed.

The general effect of Section 122 is that the loss from the operation of a business is computed without regard to other items, which are not income from or deductions of that particular business. Then the operating loss as so determined is reduced to the extent that the other income of the taxpayer exceeds the other deductions on his return. The difference as so computed is the net operating loss and it carries back and becomes the net operating loss deduction to which the taxpayer is entitled.

This clearly is the result intended by Congress. In his return, a taxpayer reports the profits and losses of each business activity separately. The results are not combined except to determine the total income and amount of tax owed by the taxpayer. Nothing in Section 122 indicates that Congress intended that separate business activities be combined for purposes of determining the net operating loss, except to prevent a carry-back or carry forward where there has been no economic loss. To combine the results would be to ignore the theory and purpose of the net operating loss provisions, which permit taxpayers to equalize the tax burden on a business which may in some years sustain a loss. A taxpayer is entitled to equalizing benefits of the net operating loss provisions to the extent that as a result of an operating loss he had suffered an economic loss, after the application of section 122(d). Had Congress intended any other result to prevail where a taxpayer conducts more than one business activity, it would have so stated the law in clear and unambiguous language.

II.**A Trade or Business Regularly Carried on by a Taxpayer Does Not Constitute a Trade or Business Regularly Carried on by the Spouse of the Taxpayer.**

The Oregon Community Property Act under which taxpayer wife, Lena L. Pierce, included in her separate 1948 tax return \$3,000.00, representing one-half of her husband's salary income (R. 25), was put into effect July 5, 1947, and was repealed on April 11, 1949, and thus was in force during 1948 (Oregon Laws of 1947, c. 525; Oregon Laws of 1949, c. 349). It is not disputed that the community property system was imposed on married persons, such as these taxpayers, domiciled in Oregon during 1948. I.T. 3868, 1947-2 Cum. Bull. 49. The District Court concluded that although the salary income received by L. H. Pierce was attributable to the trade or business regularly carried on by him as a corporate executive, his wife, Lena L. Pierce, did not engage in any such trade or business, and therefore the amount reported by her under the Oregon Community Property Law did not constitute income to her from a trade or business regularly carried on by her.

The issue presented with respect to Lena L. Pierce is not controlled by the nature of the income earned by her husband as maintained by the Government. To the contrary, the question may be simply stated as follows:

Did taxpayer Lena L. Pierce receive \$3,000.00 as income in 1948 attributable to the operation of a trade or business regularly carried on by her?

The answer, based on the facts in this case, must be "no."

In *Graham v. Commissioner*, 95 F. 2d 174 (9th Cir. 1938), relied upon by the Government, this Court construed the meaning of the term "earned income" as used in Section 31 of the Revenue Act of 1928. The pertinent provision of the statute construed by this Court in the *Graham* case provided as follows:

"Sec. 31. Earned Income Credit.

"(a) Definitions. For the purposes of this section—

"(1) 'Earned Income' means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered.
"

The Government there contended that the phrase "personal services actually rendered" meant personal services actually rendered by the taxpayer. This Court declined to read the language "by the taxpayer" into the statute, stating:

" . . . if Congress had intended such a limitation, it would have expressed that intent. It did, in the same paragraph, where limitations were intended, express such intent by using the words 'by him' and 'by the taxpayer'. No such words were used in the first part of section 31(a)(1). We conclude, therefore, that no limitation was there intended."

In the instant case, the Government would have this Court ignore the language "regularly carried on by the taxpayer" in construing Section 122(d)(5). The decision of this Court in the *Graham* case was based upon the absence of such language from the statute. The presence of the words "by the taxpayer" in Section 122(d)(5) is controlling, limiting its application to the taxpayer who actually engages in the business activity.

Lena L. Pierce did not engage in any trade or business as a corporate executive. It is the fact of engaging in a trade or business that determines whether adjustments under Section 122(d)(5) are to be made. The Government has incorrectly looked to the nature of the income earned by the husband. Subsection (5) relates to income or deductions not attributable to the "trade or business regularly carried on *by the taxpayer*." (Emphasis supplied). The taxpayer in this case is the wife. She filed separate returns and is entitled to have her taxes computed in accordance with income and deductions set forth on her returns.

The reasoning of this Court in the *Graham* case applies equally to the case at bar. That case, as well as *McLARRY v. Commissioner*, 30 F. 2d 789 (5th Cir. 1929), cited by the Government, supports taxpayer Lena L. Pierce. She did not receive any income in 1948 attributable to the operation of a trade or business regularly carried on by her. Therefore, she is entitled to deduct the nonbusiness casualty loss sustained by her in 1948 in the amount of \$3,391.47 "to the extent of the amount of gross income not derived from such trade or business." She had such gross income in the amount of \$3,000.00, so Section

122(d)(5) limits her deduction, in determining her net operating loss carryback, to that amount. The balance of the nonbusiness casualty loss is not taken in consideration, and taxpayer Lena L. Pierce's net operating loss carryback is \$2,096.56, the amount of her share of the net operating loss sustained by the partnership.

The net operating loss provision is a relief provision and, as such, should be liberally construed to carry out the purpose and intent of Congress. The judgment in favor of Lena L. Pierce in Case No. 15,462 is correct.

CONCLUSION

For the reasons above given the judgment of the District Court for the Defendant and dismissing the Complaint should be reversed and judgment directed for the taxpayer in the case of taxpayer husband on taxpayer's appeal (*L. H. Pierce v. United States*; No. 15,461), and the judgment of the District Court against the Defendant in the sum of \$1,553.55 with interest should be affirmed in the case of the taxpayer wife (*United States v. Lena L. Pierce*, No. 15,462).

Respectfully submitted,

MORRIS J. GALEN,

Of Attorneys for L. H. Pierce and
Lena L. Pierce.

JACOB, JONES & BROWN,
522 Public Service Building,
Portland 4, Oregon.

**United States
Court of Appeals
for the Ninth Circuit**

L. H. PIERCE,

Appellant.

vs.

UNITED STATES OF AMERICA,

Appellee.

UNITED STATES OF AMERICA,

Appellant,

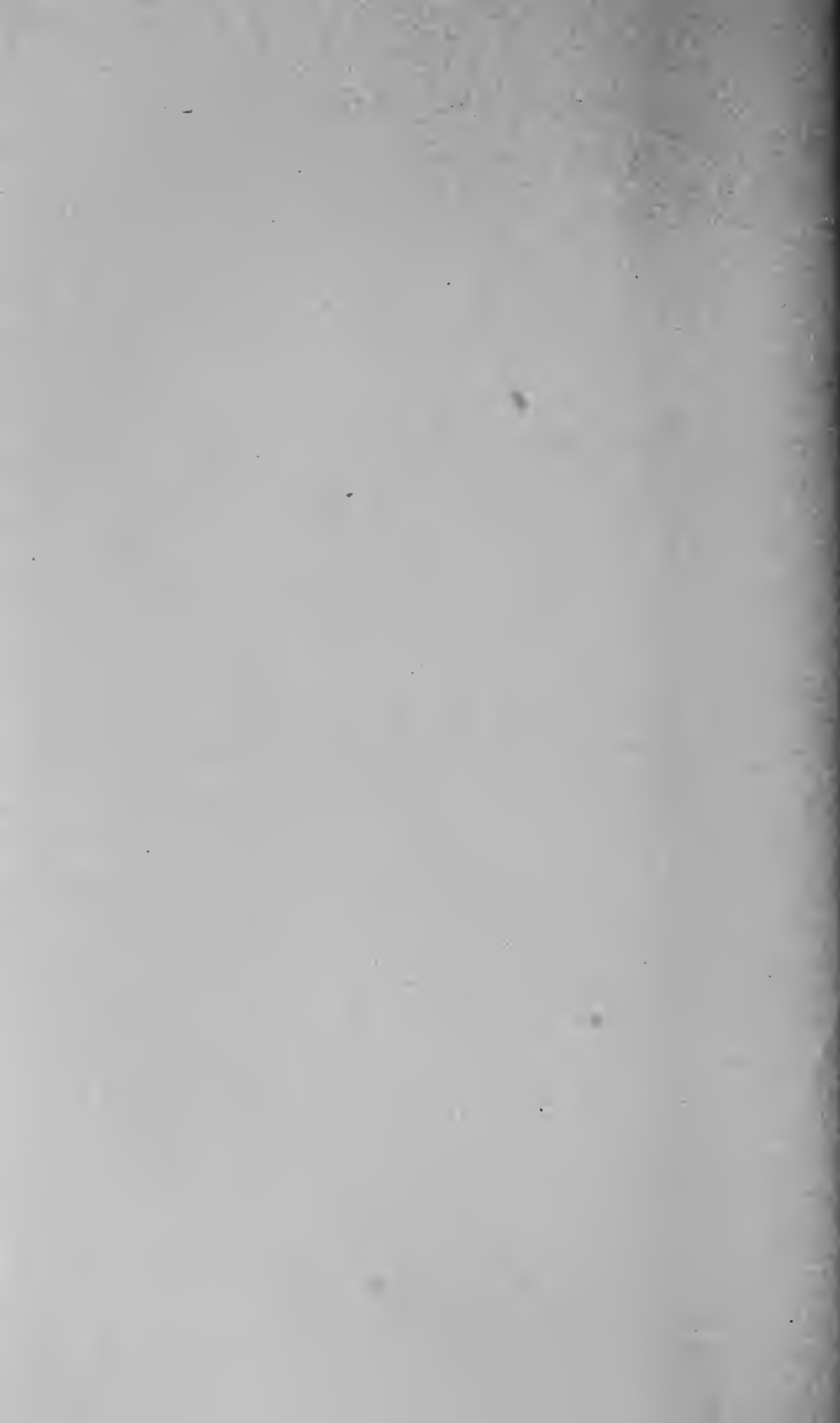
vs.

LENA L. PIERCE,

Appellee.

Transcript of Record

**Appeals from the United States District Court for the
District of Oregon**



Nos. 15461-15462

**United States
Court of Appeals**
for the Ninth Circuit

L. H. PIERCE,

Appellant.

vs.

UNITED STATES OF AMERICA,

Appellee.

UNITED STATES OF AMERICA,

Appellant,

vs.

LENA L. PIERCE,

Appellee.

Transcript of Record

**Appeals from the United States District Court for the
District of Oregon**

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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record in which the two words between which a question
to occur.

Answer

Attorney's Name

Certificate of Clerk

Complaint

Ex. A

Form for

Findings

Judgment

Judgment A

Notes of

Notes of

Notes of

Notes of

Notes of

Notes of

Notes of

Notes of

Notes of

Notes of

NAMES AND ADDRESSES OF ATTORNEYS

JACOB, JONES & BROWN,
MORRIS J. GALEN,

Public Service Building,
Portland 4, Oregon,

For Appellant.

CHARLES K. RICE,

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Department of Justice,
Washington 25, D. C.

C. E. LUCKEY,

United States Attorney;

EDWARD J. GEORGEFF,

Assistant United States Attorney,
United States Courthouse,
Portland, Oregon,

For Appellee.

1
NAMES AND ADDRESSES OF ATTORNEYS

JACOB JONES & BROWN

MORRIS J. BATES

WILLIAM BOLTON

WILLIAM H. BROWN

WILLIAM H. BROWN

WILLIAM H. BROWN

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WILLIAM H. BROWN

WILLIAM H. BROWN

WILLIAM H. BROWN

WILLIAM H. BROWN

WILLIAM H. BROWN

In the District Court of the United States
for the District of Oregon

Civil No. 7828

L. H. PIERCE,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Comes now the Plaintiff and for cause of action against the Defendant complains and alleges as follows:

I.

This is a civil action and arises under the laws of the United States of America providing for Internal Revenue and jurisdiction rests upon Title 28, United States Code, Section 1346.

II.

During the years 1946 and 1948, Plaintiff was a resident and inhabitant of the County of Multnomah and State of Oregon and was then and is now a citizen of the United States of America.

III.

Defendant now is and during all times herein mentioned was a Sovereign Power and a body politic.

IV.

At and during all times from some date in 1933 until August 31, 1947, James W. Mahoney was the duly commissioned, qualified and acting United States Collector of Internal Revenue for the District of Oregon and is hereinafter referred to as "former collector, James W. Mahoney." At and during all times from September 1, 1947, until October 31, 1952, Hugh H. Earle was the duly commissioned, qualified and acting United States Collector of Internal Revenue for the district of Oregon and is hereinafter referred to as "former collector, Hugh H. Earle."

V.

During the times herein mentioned Plaintiff kept his personal accounts and filed his personal income tax returns on a calendar year and cash receipts and disbursement basis.

VI.

During the calendar year 1946, Plaintiff's gross income was in the sum of \$66,662.26 and his net income was in the sum of \$65,790.16. On or about March 15, 1947, Plaintiff filed with the former collector, James W. Mahoney, at his office in Portland, Oregon, Plaintiff's United States Individual Income Tax Return, Form 1040, for the calendar year 1946, showing his total gross income in said sum of \$66,662.26 and a total tax liability of Plaintiff for the said year in the sum of \$36,456.66, which Plaintiff paid to former collector, James W. Mahoney.

VII.

On January 1, 1935, plaintiff and his wife, Lena Pierce, entered into a partnership agreement to carry on a business of manufacturing trailers in Portland, Multnomah County, Oregon, as partners under the name and style of L. H. Pierce Auto Service and to share the profits and losses of said business at all times from January 1, 1935, through December 31, 1948, as follows:

L. H. Pierce	50%
Lena Pierce	50%

and at all times from January 1, 1935, through December 31, 1948, said business was carried on, operated and conducted as a partnership by Plaintiff and his wife as partners in accordance with said agreement. During the calendar year 1948 the partnership sustained a loss of Four Thousand One Hundred Ninety Three and 12/100 (\$4,193.12) Dollars and Plaintiff's share of said loss was Two Thousand Ninety Six and 56/100 (\$2,096.56) Dollars. Said loss resulted from the operation of said partnership business of Plaintiff and his said partner.

VIII.

During the year 1948, Plaintiff sustained an operating loss of Two Thousand Ninety Six and 56/100 (\$2,096.56) Dollars, the same being his said distributive share of said operating loss sustained by said partnership, L. H. Pierce Auto Service. During the same year Plaintiff had a non-business casualty loss in the amount of Three Thousand Three Hun-

dred Ninety One and 47/100 (\$3,391.47) Dollars and received a salary of Three Thousand (\$3,000.00) Dollars. Under Section 122 of the Internal Revenue Code, (26 U.S.C.A. Sect. 122) the casualty loss completely offsets the salary in the amount of Three Thousand (\$3,000.00) Dollars. Plaintiff filed with the former collector, Hugh H. Earle, at his office in Portland, Oregon, Plaintiff's United States Individual Income Tax Return, Form 1040, for the year 1948 showing his said net operating loss in the year 1948 amounting to Two Thousand Ninety Six and 56/100 (\$2,096.56) Dollars.

IX.

Under Section 122 of the Internal Revenue Code and Section 23 (s) (26 U.S.C.A., Section 23 (s)) said operating loss of Plaintiff in the sum of Two Thousand Ninety Six and 56/100 (\$2,096.56) Dollars for the year 1948 becomes a net operating loss deduction in the calendar year 1946 and reduces Plaintiff's net taxable income in 1946 from \$65,790.16 to \$63,693.60, and reduces his income tax liability for said year from \$36,456.66 to \$34,903.11, a reduction in tax liability of One Thousand Five Hundred Fifty Three and 55/100 (\$1,553.55) with the result that the income taxes collected from Plaintiff for the year 1946 were excessive by said sum of One Thousand Five Hundred Fifty Three and 55/100 (\$1,553.55) Dollars.

X.

Said sum of One Thousand Five Hundred Fifty Three and 55/100 (\$1,553.55) Dollars has not been

repaid to the Plaintiff, nor has any part thereof been repaid to him, and Defendant now erroneously and wrongfully withholds from Plaintiff said sum of One Thousand Five Hundred Fifty Three and 55/100 (\$1,553.55) Dollars, and the whole thereof, together with interest thereon at the rate of six (6%) per cent per annum from January 1, 1949, as provided by law.

XI.

At or about the same time that Plaintiff filed his said tax return for the year 1948 and on or about the 15th day of March, 1949, he also duly filed with the former collector, Hugh H. Earle, in the collector's office in Portland, Oregon on Form 843, Plaintiff's claim for refund to him of said sum of One Thousand Five Hundred Fifty Three and 55/100 (\$1,553.55) Dollars. A copy of said claim marked "Exhibit A" is attached hereto and by this reference made a part hereof.

XII.

More than six (6) months have elapsed since the said claim was filed as aforesaid, and neither the Commissioner of Internal Revenue nor the Secretary of the Treasury of the United States, nor any delegate of his, has mailed by registered mail to the Plaintiff a notice of the disallowance of said claim or any part thereof.

Wherefore, Plaintiff demands judgment in the sum of One Thousand Five Hundred Fifty Three and 55/100 (\$1,553.55) Dollars, together with in-

terest at the rate of six (6%) per cent per annum from January 1, 1949, as provided by law and for his costs and disbursements herein incurred.

/s/ RANDALL JONES,

/s/ GARTHE BROWN,

/s/ MORRIS J. GALEN,

Attorneys for Plaintiff.

Of Counsel:

JACOB, JONES & BROWN.

State of Oregon,
County of Multnomah—ss.

I, L. H. Pierce, being first duly sworn, say that I am the Plaintiff in the within entitled action and that the foregoing Complaint is true as I verily believe.

/s/ L. H. PIERCE.

Subscribed and sworn to before me this 6th day of December, 1954.

[Seal] /s/ F. M. WACHSMUTH,

Notary Public for Oregon.

My Commission expires: December 6, 1954.

EXHIBIT A

Form 843

U. S. Treasury Department
Internal Revenue Service

Claim

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below
the kind of claim filed, and fill in, where required,
the certificate on the back of this form

☒ Refund of Taxes Illegally, Erroneously, or
Excessively Collected.

Name of taxpayer or purchaser of stamps: L. H.
Pierce.

Residence: 6832 N. E. 107th Avenue, Portland,
Oregon.

1. District in which return (if any) was filed:
Portland, Oregon.
2. Period (if for tax reported on annual basis, pre-
pare separate form for each taxable year) from
1/1, 1946, to 12/31, 1946.

* * *

6. Amount to be refunded: \$1,553.55.

* * *

The claimant believes that this claim should be
allowed for the following reasons:

By application of the Federal Carry Back Loss Rule to the Operating Loss of 1948 against the Net Operating Profit for the year of 1946.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

/s/ L. H. Pierce.

Dated....., 19..

L. H. Pierce,
6832 N. E. 107th Avenue,
Portland, Oregon.

Carry Back Analysis of 1948 Operating Loss
to the Calendar Year of 1946

Line 6 Form 1040 for Year 1946.....	\$66,662.26
Less: Less 1948 Operating Loss	2,096.56
	<hr/>
Balance subject to tax	\$64,565.70
	<hr/> <hr/>
Amount of Tax Originally Paid.....	\$36,456.66
Amount of Tax Due on Above Balance	
Subject to Tax	34,903.11
	<hr/>
Excess Tax Paid and Claimed as Refund	\$ 1,553.55
	<hr/> <hr/>

[Endorsed]: Filed December 8, 1954.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant, the United States of America, by its attorney, Clarence Edwin Luckey, United States Attorney for the District of Oregon, in answer to the plaintiff's Complaint herein:

I.

Denies the allegations contained in said complaint not admitted, qualified or specifically referred to below.

II.

Further answering plaintiff's complaint:

1. Admits the allegations contained in paragraph I of the complaint.

2. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph II of the complaint.

3. Admits the allegations contained in paragraph III of the complaint.

4. Admits the allegations contained in paragraph IV of the complaint.

5. Admits the allegations contained in paragraph V of the complaint.

6. Denies the allegations contained in paragraph VI of the complaint but admits that on May 14, 1947, the plaintiff filed with the former Collec-

tor, James W. Mahoney, at Portland, Oregon, the plaintiff's federal income tax return, Form 1040, for the calendar year 1946, and disclosed thereon gross income in the total sum of \$66,662.26, a total tax liability of \$36,456.66. Defendant further admits that plaintiff paid the said tax to former Collector, James W. Mahoney.

7. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph VII of the complaint but admits that the alleged partnership filed a Treasury Department Form 1065 for the calendar year 1948 and showed thereon a loss of \$4,193.12. The said partnership return further disclosed that plaintiff's share of the alleged loss was \$2,096.56.

8. Denies the allegations contained in paragraph VIII of the complaint but admits that the plaintiff filed with the former Collector, Hugh H. Earle, at Portland, Oregon, the plaintiff's federal income tax return, Form 1040, for the year 1948, and showed thereon an amount alleged to be his share of the net operating loss of the alleged partnership in the amount of \$2,096.56. The return further showed that the plaintiff claimed a casualty loss in the amount of \$3,391.47 and that plaintiff had received a salary of \$3,000.

9. Denies the allegations contained in paragraph IX of the complaint.

10. Denies the allegations contained in paragraph X of the complaint but admits that no part of the sum of \$1,553.55 has been repaid to the plaintiff.

11. Denies the allegations contained in paragraph XI of the complaint but admits that on June 7, 1949, the plaintiff filed with the former Collector, Hugh H. Earle, at Portland, Oregon, a claim for refund on Form 843, for the sum of \$1,553.55. It is further admitted that a copy of the said claim is attached to the complaint as Exhibit A, but defendant denies all substantive allegations contained in the said claim for refund.

12. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph XII of the complaint.

Affirmative Defense

If it is the decision of this Court that the plaintiff is entitled to a deduction under Section 122 of the Internal Revenue Code of 1939, then the plaintiff will be limited to a refund of \$1,346.49 instead of \$1,553.55, as claimed, for the reason that the plaintiff in computing his alleged operating loss deduction failed to take into consideration the non-taxable portion of his 1948 long term capital gains of \$279.43 each.

Wherefore, the defendant prays that the com-

plaint be dismissed with prejudice and the defendant be allowed its costs and disbursements.

C. E. LUCKEY,
United States Attorney for
the District of Oregon.

/s/ EDWARD J. GEORGEFF,
Assistant United States
Attorney.

Affidavit of Service by Mail attached.

[Endorsed]: Filed February 7, 1955.

In the United States District Court
for the District of Oregon
Civil No. 7828

L. H. PIERCE,
Plaintiff,
vs.
UNITED STATES OF AMERICA,
Defendant.

Civil No. 7829

LENA L. PIERCE,
Plaintiff,
vs.
UNITED STATES OF AMERICA,
Defendant.

PRE-TRIAL ORDER

The above-entitled actions came on regularly for pre-trial conference before the Honorable Gus J.

Solomon, Judge of the above-entitled Court on the 27th day of June, 1955, Plaintiffs appearing by Jacob, Jones & Brown and Morris J. Galen, their attorneys of record herein, and the Defendant appearing by C. E. Luckey, United States Attorney for the District of Oregon, and being represented in Court by Richard M. Roberts, special assistant to the Attorney-General, Department of Justice, Washington, D. C.

Character of the Actions

It appearing from the pleadings and statement of counsel that in the above-entitled actions the plaintiffs seek to recover of and from the defendant sums of money which Plaintiffs allege the Defendant erroneously and wrongfully withholds from the Plaintiffs as income taxes and interest thereon for the calendar year, 1946, which sums of money Plaintiffs allege are wrongfully withheld by virtue of the Defendant's failure to recognize and allow to each of the Plaintiffs a net operating loss carry-back from the year 1948 to the year 1946.

Upon the proceedings had at the pre-trial hearing,

It Is Ordered that the above-entitled actions be and they are hereby consolidated for trial; and

Admitted Facts

It Is Ordered that the following facts are admitted by the parties and are accepted as stipulated facts in this case:

I.

Each of the above-captioned actions is a civil action and arises under the laws of the United States of America providing for internal revenue and jurisdiction rests upon Title 28, United States Code, Section 1346.

II.

During the years 1946 and 1948, each of the Plaintiffs was a resident and inhabitant of the County of Multnomah and State of Oregon, and was then and is now a citizen of the United States of America.

III.

Defendant now is and during all times herein mentioned was a sovereign power and body politic.

IV.

At and during all times from July 16, 1933 to August 31, 1947, James W. Maloney was the duly commissioned, qualified and acting United States Collector of Internal Revenue for the District of Oregon.

V.

At and during all times from September 1, 1947, to October 30, 1952, Hugh H. Earle was the duly commissioned, qualified and acting United States Collector of Internal Revenue for the District of Oregon.

VI.

During all times herein mentioned, Plaintiff, L. H. Pierce, kept his books and made and filed his tax returns on a calendar year and cash receipts and

disbursements basis.

VII.

During all times herein mentioned, Plaintiff, Lena L. Pierce, kept her books and made and filed her tax returns on a calendar year and cash receipts and disbursements basis.

VIII.

During the calendar year 1946, Plaintiff, L. H. Pierce, had a gross income in the sum of \$66,662.26 and net income in the sum of \$65,790.16. On or about March 15, 1947, Plaintiff, L. H. Pierce, filed with the former collector, James W. Maloney, at his office in Portland, Oregon, his United States Individual Income Tax Return, Form 1040, for the Calendar Year 1946, showing his total gross income in said sum of \$66,662.26, and a total tax liability for said year in the sum of \$36,456.66, which Plaintiff, L. H. Pierce, paid to the former collector, James W. Maloney. A copy of L. H. Pierce's United States Individual Income Tax Return for the year 1946 is Plaintiff's Pre-trial Exhibit 1.

IX.

During the calendar year 1946, Plaintiff, Lena L. Pierce, had a gross income in the sum of \$66,662.25 and net income in the sum of \$65,825.45. On or about March 15, 1947, Plaintiff, Lena L. Pierce filed with the former collector, James W. Maloney, at his office in Portland, Oregon, her United States Individual Income Tax Return, Form 1040, for the calendar year 1946, showing her total

gross income in said sum of \$66,662.25, and a total tax liability for said year in the sum of \$36,112.31, which Plaintiff, Lena L. Pierce, paid to the former collector, James W. Maloney. A copy of Lena L. Pierce's United States Individual Income Tax Return for the year 1946 is Plaintiffs' Pre-trial Exhibit 2.

X.

On January 1, 1935, L. H. Pierce and Lena L. Pierce, the Plaintiffs herein, entered into a partnership agreement pursuant to which they engaged in business as partners, in and about Portland, Multnomah County, Oregon, under the name and style of L. H. Pierce Auto Service. The said partnership engaged in the manufacture of trailers and in other related and unrelated business activity. Plaintiffs shared the profits and losses of said business at all times from January 1, 1935, through December 31, 1948, as follows:

L. H. Pierce	50%
Lena L. Pierce	50%

XI.

On or about April 2, 1947, Pierce Trailer & Equipment Co., an Oregon corporation, was organized, with each of the Plaintiffs owning fifty (50%) per cent of the issued and outstanding stock of said corporation. The corporation engaged in the trailer business, and after the organization of the corporation, the partnership ceased engaging in the trailer business, but continued to conduct business operations not connected with those of the

corporation. After April 2, 1947, the partnership owned property which it leased to the corporation and continued its farming operations.

XII.

During the calendar year 1948, the partnership sustained a net operating loss of \$4,193.12 and thereby each of the Plaintiffs sustained an operating loss of \$2,096.56. A copy of the partnership's United States Partnership Return of Income, Form 1065, for the year 1948 is Plaintiffs' Pre-trial Exhibit 3.

XIII.

During the calendar year 1948, L. H. Pierce received a salary of \$6,000.00 from Pierce Trailer & Equipment Co., which salary was reported for Federal Income Tax purposes in the amount of \$3,000.00 by each of the Plaintiffs. A copy of the corporation's United States Corporation Income Tax Returns, Form 1120, for the fiscal years ending March 31, 1948, and March 31, 1949, are Defendant's Pre-trial Exhibits 1 and 2 respectively.

XIV.

During the year 1948, each of the Plaintiffs had a non-business casualty loss in the amount of \$3,391.47.

XV.

L. H. Pierce filed with the former collector, Hugh H. Earle, at his office in Portland, Oregon, his United States Individual Income Tax Return, Form 1040, for the year 1948, showing his said net oper-

ating loss in the year 1948 amounting to \$2,096.56. A copy of L. H. Pierce's United States Individual Income Tax Return for the year 1948 is Plaintiff's Exhibit 4.

XVI.

Lena L. Pierce filed with the former collector, Hugh H. Earle, at his office in Portland, Oregon, her United States Individual Income Tax Return, Form 1040, for the year 1948, showing her said net operating loss in the year 1948 amounting to \$2,096.56. A copy of Lena L. Pierce's United States Individual Income Tax Return for the year 1948 is Plaintiffs' Exhibit 5.

XVII.

On or about the 7th day of June, 1949, L. H. Pierce duly filed with the former collector, Hugh H. Earle, in the Collector's Office in Portland, Oregon, on Form 843, his claim for refund to him of the sum of \$1,553.55. A copy of said claim is marked Plaintiff's Pre-trial Exhibit 6. More than Six (6) months have elapsed since the date said claim was filed as aforesaid, and the Commissioner of Internal Revenue has rendered no decision thereon.

XVIII.

Said sum of \$1,553.55 has not been repaid to Plaintiff, L. H. Pierce, nor has any part thereof been repaid to him.

XIX.

On or about the 7th day of June, 1949, Lena L. Pierce duly filed with the former collector, Hugh H. Earle, in the Collector's Office in Portland, Ore-

gon, on Form 843, her claim for refund to her of the sum of \$1,553.55. A copy of said claim is marked Plaintiffs' Pre-trial Exhibit 7. More than Six (6) months have elapsed since the date said claim was filed as aforesaid, and the Commissioner of Internal Revenue has rendered no decision thereon.

XX.

Said sum of \$1,553.55 has not been repaid to the Plaintiff, Lena L. Pierce, nor has any part thereof been repaid to her.

Issues

Issues of Fact:

1. There are no issues of fact to be tried by the court.

Issues of Law:

1. Whether under Section 122 of the Internal Revenue Code of 1939 and Section 23 (s) (26 U.S.C.A. Section 23 (s)) the said operating loss sustained by L. H. Pierce in the sum of \$2,096.56 for the year 1948 became a net operating loss deduction in the calendar year 1946 and reduced L. H. Pierce's net taxable income in 1946 from \$65,-790.16 to \$63,693.60, and reduced his income tax liability for said year from \$36,456.66 to \$34,903.11, a reduction in tax liability of \$1,553.55.

2. Whether under Section 122 of the Internal Revenue Code of 1939 and Section 23 (s) (26 U.S.C.A. Section 23 (s)) the said operating loss sustained by Lena L. Pierce in the sum of \$2,-

096.56 for the year 1948 became a net operating loss deduction in the calendar year 1946 and reduced Lena L. Pierce's net taxable income in 1946 from \$65,825.45 to \$63,728.89, and her income tax liability for said year from \$36,112.31 to \$34,558.76, a reduction in tax liability of \$1,553.55.

3. Whether the salary income received by L. H. Pierce from Pierce Trailer & Equipment Co., was income from trade or business to L. H. Pierce and Lena L. Pierce.

4. Whether Plaintiffs' non-business casualty loss deductions can be used to offset the salary income received by L. H. Pierce.

5. Whether Plaintiff, L. H. Pierce, is entitled to recover from the Defendant the sum of \$1,553.55, together with interest thereon at the rate of six (6%) per cent per annum from January 1, 1949, as provided by law, together with his costs and disbursements in case No. 7828.

6. Whether Plaintiff, Lena L. Pierce, is entitled to recover from the Defendant the sum of \$1,553.55, together with interest thereon at the rate of Six (6%) per cent per annum from January 1, 1949, as provided by law, together with her costs and disbursements in case No. 7829.

Exhibits

It Is Ordered that the parties hereto may offer in evidence at the trial of this action any and all of the following pre-trial exhibits without further

identification or authentication, but subject to any and all objections on other grounds:

Plaintiff's Exhibits

1. Copy of Plaintiff, L. H. Pierce's, United States Individual Income Tax Return for the calendar year 1946.

2. Copy of Plaintiff, Lena L. Pierce's, Individual Income Tax Return for the calendar year 1946.

3. Copy of the United States Partnership Income Tax Return of L. H. Pierce Auto Service for the year 1948.

4. Copy of Plaintiff, L. H. Pierce's, United States Individual Income Tax Return for the calendar year 1948.

5. Copy of Plaintiff, Lena L. Pierce's, United States Individual Income Tax Return for the calendar year 1948.

6. Copy of Plaintiff, L. H. Pierce's, Refund Claim for the year 1946 in the sum of \$1,553.55.

7. Copy of Plaintiff, Lena L. Pierce's, Refund Claim for the year 1946 in the sum of \$1,553.55.

Defendant's Exhibits

1. Copy of the corporation's United States Corporation Income Tax Return for the fiscal year ending March 31, 1948.

2. Copy of the corporation's United States Corporation Income Tax Return for the fiscal year ending March 31, 1949.

It Is Ordered that the above-entitled Court has jurisdiction of the parties and the subject matter of this action.

The foregoing is certified to be a record of the proceedings had at the pre-trial of this case; and

It Is Ordered that the questions to be tried herein shall be as hereinabove set forth; and

It Is Further Ordered that this Pre-trial Order shall not be changed or additions made thereto, except by written agreement of the parties, acting through their respective attorneys, or upon order of the court to prevent manifest injustice.

Dated at Portland, Oregon, this 5th day of July, 1955.

/s/ GUS J. SOLOMON,
Judge.

Approved:

/s/ MORRIS J. GALEN,
Of Attorneys for Plaintiffs.

/s/ RICHARD W. ROBERTS,
Of Attorneys for Defendant.

Lodged July 1, 1955.

[Endorsed]: Filed July 5, 1955.

[Title of District Court and Cause.]

Civil Action Nos. 7828 and 7829

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled actions came on regularly for trial before the Honorable William G. East, Judge of the above-entitled Court, on the basis of stipulated facts contained in a pre-trial order, including exhibits, filed in this Court onand briefs having been filed by the respective parties, the findings of fact and conclusions of law follow:

Findings of Fact

I.

Plaintiff, Lena L. Pierce, is involved here solely by virtue of her being the wife of plaintiff, L. H. Pierce, during the pertinent years. The plaintiffs filed separate individual income tax returns for the relevant years. Plaintiff, Lena L. Pierce, is involved in this proceeding because, under Oregon community property law, she reported one-half of the items here at issue on her federal income tax return as her share of the community property.

II.

Each of the above captioned actions is a civil action and arises under the laws of the United States of America providing for internal revenue and jurisdiction rests upon Title 28, United States Code, Section 1346.

III.

During the years 1946 and 1948, each of the plaintiffs was a resident and inhabitant of the County of Multnomah and State of Oregon, and was then and is now a citizen of the United States of America.

IV.

During all times herein mentioned, plaintiff, L. H. Pierce, kept his books and made and filed his tax returns on a calendar year and cash receipts and disbursements basis.

V.

During all times herein mentioned, plaintiff, Lena L. Pierce, kept her books and made and filed her tax returns on a calendar year and cash receipts and disbursements basis.

VI.

During the calendar year 1946, plaintiff, L. H. Pierce, had a gross income in the sum of \$66,662.26 and net income in the sum of \$65,790.16. On or about March 15, 1947, plaintiff, L. H. Pierce, filed with the former collector, James W. Maloney, at his office in Portland, Oregon, his United States Individual Income Tax Return, Form 1040, for the calendar year 1946, showing his total gross income in said sum of \$66,662.26, and a total tax liability for said year in the sum of \$36,456.66, which plaintiff, L. H. Pierce, paid to the former collector, James W. Maloney.

VII.

During the calendar year 1946, Plaintiff, Lena L. Pierce, had a gross income in the sum of \$66,662.25

and net income in the sum of \$65,825.45. On or about March 15, 1947, plaintiff, Lena L. Pierce filed with the former collector, James W. Maloney, at his office in Portland, Oregon, her United States Individual Income Tax Return, Form 1040, for the calendar year 1946, showing her total gross income in said sum of \$66,662.25, and a total tax liability for said year in the sum of \$36,112.31, which plaintiff, Lena L. Pierce, paid to the former collector, James W. Maloney.

VIII.

On January 1, 1935, L. H. Pierce and Lena L. Pierce, the plaintiffs herein, entered into a partnership agreement pursuant to which they engaged in business as partners, in and about Portland, Multnomah County, Oregon, under the name and style of L. H. Pierce Auto Service. The said partnership engaged in the manufacture of trailers and in other related and unrelated business activity. Plaintiffs shared the profits and losses of said business at all times from January 1, 1935, through December 31, 1948, as follows:

L. H. Pierce	50%
Lena L. Pierce	50%

IX.

On or about April 2, 1947, Pierce Trailer & Equipment Co., an Oregon corporation, was organized, with each of the plaintiffs owning Fifty (50%) per cent of the issued and outstanding stock of said corporation. The corporation engaged in the

trailer business, and after the organization of the corporation, the partnership ceased engaging in the trailer business, but continued to conduct business operations not connected with those of the corporation. After April 2, 1947, the partnership owned property which it leased to the corporation and continued its farming operations.

X.

During the year 1948 the partnership, L. H. Pierce Auto Service, sustained a net operating loss of \$4,193.12. One-half, or \$2,096.56 was sustained by each of the plaintiffs as partners and was reported by them on their separate 1948 Federal income tax returns. L. H. Pierce was president of Pierce Trailer & Equipment Co. in 1948. During 1948 L. H. Pierce received a salary of \$6,000.00 from Pierce Trailer & Equipment Co. One-half or \$3,000.00 of this salary was reported on the separate 1948 Federal income tax returns of each of the plaintiffs on their separate returns.

XI.

Plaintiff L. H. Pierce, as president of Pierce Trailer & Equipment Co. received a salary of \$6,000.00 from the corporation in 1948. One-half, or \$3,000.00, was reported on their separate 1948 Federal income tax returns by each of the plaintiffs.

XII.

During the year 1948, each of the plaintiffs incurred a non-business casualty loss in the amount

of \$3,391.47, which they deducted on their separate 1948 Federal income tax returns.

XIII.

On or about the 7th day of June, 1949, L. H. Pierce and Lena L. Pierce each duly filed with the former collector, Hugh H. Earle, in the Collector's Office in Portland, Oregon, on Form 843, their separate claims for refund for the year 1946 each in the amount of \$1,553.55, alleging an overpayment of income tax based upon a net operating loss carry-back from 1948 in the amount of \$2,096.56 resulting from the operation of the partnership.

XIV.

Said sum of \$1,553.55 has not been repaid to plaintiff, L. H. Pierce, nor has any part thereof been repaid to him.

XV.

Said sum of \$1,553.55 has not been repaid to the plaintiff, Lena L. Pierce, nor has any part thereof been repaid to her.

Conclusions of Law

I.

In 1948, only one-half of the \$6,000.00 or \$3,000.00 received by plaintiff, L. H. Pierce, from Pierce Trailer & Equipment Co., Inc., as salary for services rendered to the corporation as president was income received by him in the operation of a trade or business. Accordingly, in the computation of

the net operating loss deduction under Section 122 of the Internal Revenue Code of 1939 the \$3,000.00 received and reported by plaintiff, L. H. Pierce, in 1948, from Pierce Trailer & Equipment Co., Inc., must be offset against his distributable share of the operating loss in the amount of \$2,096.56 of the L. H. Pierce Auto Service partnership.

II.

The plaintiff, L. H. Pierce, is not entitled to any net operating loss deduction for the year 1946 under the provisions of Section 23 (a) of the Internal Revenue Code of 1939. His complaint must be dismissed with prejudice.

III.

The \$3,000.00 reported by plaintiff, Lena L. Pierce, in 1948, under the community property law of the State of Oregon representing one-half of the salary paid to her husband, L. H. Pierce, by Pierce Trailer & Equipment Co., Inc., in 1948 for his services as president did not constitute income to her from her trade or business.

IV.

Plaintiff, Lena L. Pierce, is entitled in the computation of the net operating loss deduction under section 122 of the Internal Revenue Code of 1939 for the year 1946 to treat the \$3,000.00 reported by her in 1948 as representing one-half of the salary of plaintiff L. H. Pierce as income not attributable to a trade or business.

V.

Plaintiff, Lena L. Pierce, is entitled to a deduction for the year 1946 under Section 23 (a) of the Internal Revenue Code of 1939 in the amount of \$2,096.56 as a net operating loss carry-back from the year 1948.

VI.

Plaintiff, Lena L. Pierce, is entitled to judgment accordingly.

/s/ WILLIAM G. EAST,

United States District Judge.

Dated: October 8, 1956.

[Endorsed]: Filed October 8, 1956.

In the United States District Court
for the District of Oregon

Civil Action No. 7828

L. H. PIERCE,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

This matter came on regularly by trial before the undersigned Judge of the above-entitled Court, the plaintiff appearing by Morris J. Galen, of his attorneys, and the defendant appearing by C. E.

Luckey, United States Attorney for the District of Oregon, Edward J. Georgeff, Assistant United States Attorney, and Walter B. Langley, Special Assistant to the Attorney General, of defendant's attorneys, and the Court having entered its pre-trial order herein, in which no issues of fact were raised and having entered Findings of Fact and Conclusions of Law, and the Court being fully advised in the premises, it is hereby

Ordered, Adjudged and Decreed, that judgment is entered for the defendant and plaintiff's complaint is dismissed with prejudice.

Dated this 29th day of October, 1956.

/s/ WILLIAM G. EAST,
Judge.

[Endorsed]: Filed October 29, 1956.

In the United States District Court
for the District of Oregon
Civil Action No. 7829

LENA L. PIERCE,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

This matter came on regularly by trial before the undersigned Judge of the above-entitled Court,

the plaintiff appearing by Morris J. Galen, of her attorneys, and the defendant appearing by C. E. Luckey, United States Attorney for the District of Oregon, Edward J. Georgeff, Assistant United States Attorney, and Walter B. Langley, Special Assistant to the Attorney General, of defendant's attorneys, and the Court having entered its pre-trial order herein, in which no issues of fact were raised and having entered Findings of Fact and Conclusions of Law, and the Court being fully advised in the premises, it is hereby

Ordered, Adjudged and Decreed, that judgment be, and the same is, hereby entered for plaintiff and against the defendant in the sum of One Thousand Five Hundred Fifty Three and 55/100 dollars (\$1,553.55), together with interest thereon at the rate of six per cent per annum from the 7th day of June, 1949, and

It Is Further Ordered, Adjudged and Decreed, that plaintiff have and recover of and from the defendant, her costs and disbursements herein taxed at \$.....

Dated this 29th day of October, 1956.

/s/ WILLIAM G. EAST,
Judge.

[Endorsed]: Filed October 29, 1956.

[Title of District Court and Cause.]

Civil Action No. 7828

NOTICE OF APPEAL

Notice is hereby given that L. H. Pierce, Plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on October 29, 1956.

/s/ MORRIS J. GALEN,
Of Attorneys for Plaintiff,
L. H. Pierce.

[Endorsed]: Filed December 5, 1956.

[Title of District Court and Cause.]

Civil 7829

NOTICE OF APPEAL

To: Lena L. Pierce, Plaintiff, and Jacob, Jones & Brown, Attorneys for Plaintiff:

Notice Is Hereby Given that the United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final Judgment entered in this action on the 29th day of October, 1956, in favor of plaintiff and against defendant.

Dated December 5, 1956.

C. E. LUCKEY,

United States Attorney,
District of Oregon;

/s/ EDWARD J. GEORGEFF,

Assistant United States Attorney, of Attorneys for
Defendant.

[Endorsed]: Filed December 5, 1956.

[Title of District Court and Cause.]

Civil Action No. 7828

COST BOND

Know All Men by These Presents, that the Aetna Casualty and Surety Company, of Hartford Connecticut, a corporation organized and existing under the laws of the State of Connecticut and authorized to transact the business of Surety in the State of Oregon is held and firmly bound unto The United State of America, the defendant in the above-entitled action, in the penal sum of Two Hundred Fifty and No/100 (250.00) Dollars, lawful money of the United States of America for the payment of which well and truly to be made it binds itself, heirs and successors.

Upon condition, nevertheless, that

Whereas, L. H. Pierce, the plaintiff in the above-entitled action, has appealed to The United States

Court of Appeals for the 9th District from the Judgment made and entered in the said action in the said District Court in favor of the defendant and against the plaintiff in the said action on the 29th day of October, 1956.

Now, if L. H. Pierce shall well and truly pay all costs and disbursements that may be awarded by the said United States Court of Appeals for the 9th Circuit; if the appeal be dismissed or the judgment affirmed or modified, then this obligation to be null and void; otherwise to remain in full force and effect.

Signed, sealed and dated this 5th day of December, 1956.

[Seal]

THE AETNA CASUALTY AND
SURETY COMPANY,

By /s/ S. R. WALSH,
Res. Vice-President.

Attest:

/s/ G. TURNER,
Res. Asst. Secretary.

[Endorsed]: Filed December 5, 1956.

[Title of District Court and Cause.]

Civil No. 7828

ORDER

This matter coming on to be heard ex parte upon motion of plaintiff for an order extending time for

the filing of the record on appeal and docketing the within action in the United States Court of Appeals for the Ninth Circuit, to enable the attorneys for the plaintiff to have additional time to consider said appeal, and the Court being fully advised in the premises,

It Is Ordered that the time for filing the record on appeal and docketing the within action be and it is hereby extended to 90 days from the 5th day of December, 1956, the date of filing of the Notice of Appeal.

Dated this 14th day of January, 1957.

/s/ WILLIAM G. EAST,
Judge.

[Endorsed]: Filed January 14, 1957.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Oregon—ss.

I, R. DeMott, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of Complaint; Answer: Pre-trial order (also in Civ. 7829); Findings of fact and conclusions of law (also in Civ. 7829); Judgment; Notice of appeal; Cost bond; Order extending time to docket appeal; Designation

of record and Transcript of docket entries, constitute the record on appeal from a judgment of said court in a cause therein numbered Civil 7828, in which L. H. Pierce is the plaintiff and appellant and The United States of America is the defendant and appellee; that the said record has been prepared by me in accordance with the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

I further certify that the exhibits will be forwarded at a later date.

And I further certify that the cost of filing the notice of appeal, \$5.00, has been paid by the appellant.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 28th day of February, 1957.

[Seal]

R. DeMOTT,
Clerk;

By /s/ THORA LUND,
Deputy.

[Endorsed]: No. 15461. United States Court of Appeals for the Ninth Circuit. L. H. Pierce, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed March 4, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

[Endorsed]: No. 15462. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Lena L. Pierce, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed March 4, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

Case No. 15461

L. H. PIERCE,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STATEMENT OF POINTS ON WHICH
APPELLANT INTENDS TO RELY

The above-named Appellant, L. H. Pierce, intends to rely on the following points on his appeal to the United States Court of Appeals for the Ninth Circuit, to wit:

1. The Trial Court erred in making its conclusions of law I and II in that they are each contrary to the law governing this case.

2. The Trial Court erred in rendering judgment, dismissing Appellant's Complaint with prejudice, in that said judgment is contrary to the law governing this case.

Dated this 20th day of March, 1957.

/s/ MORRIS J. GALEN,

Of Attorneys for Appellant.

Service of copy acknowledged.

[Endorsed]: Filed March 22, 1957.

[Title of Court of Appeals and Cause.]

No. 15462

APPELLANT'S STATEMENT OF POINTS
ON APPEAL

Pursuant to Rule 17 (6) of this Court the appellant, United States of America, hereby files the following statement of points on which it intends to rely:

1. The District Court erred in holding that where the activities of the appellee's husband in 1948 were sufficient to constitute the operation of a trade or business and where, under the community property law of the State of Oregon, one-half of the income attributable to the operation of such trade or business was reported by the appellee on her 1948 individual federal income tax return, that such income did not constitute trade or business income to the appellee.

2. The District Court erred in holding that the appellee, in the computation of the net operating loss deduction under Section 122 of the Internal Revenue Code of 1939 for the year 1946, was entitled to treat as non-business income the amount reported by her in 1948 which was attributable to the activities of her husband in the operation of a trade or business.

3. The District Court erred in holding that appellee was entitled to a deduction for the year 1946 under Section 23 (a) of the Internal Revenue Code of 1939 in the amount of \$2,096.56 as a net operating loss carry-back from the year 1948.

4. The District Court erred in ordering judgment for the appellee in the amount of \$1,553.55.

Dated: March 29, 1957.

/s/ CLARENCE E. LUCKEY,
United States Attorney.

Service of copy acknowledged.

[Endorsed]: Filed April 1, 1957.

In the United States Court of Appeals
for the Ninth Circuit

No. 15461

L. H. PIERCE,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

No. 15462

UNITED STATES OF AMERICA,

Appellant,

vs.

LENA L. PIERCE,

Appellee.

STIPULATION FOR CONSOLIDATION AND
SUBMISSION OF CASES ON A COMMON
PRINTED RECORD, BRIEFS, HEARING
AND ARGUMENT

The above-entitled cases having been consolidated for submission to the District Court on a common pre-trial order and briefs, and the Court's letter

decisions and Findings of Fact and conclusions of Law being applicable to both cases, plaintiff appealing the adverse decision in one of the cases and defendant United States appealing the adverse decision in the other case.

It Is Hereby Stipulated by and between the parties, through their respective attorneys, subject to the approval of the Court, that the cases may be consolidated on appeal and submitted on a common printed record, the expenses of printing said record to be shared equally, briefs, hearing and argument, the first brief to be filed by the government, which brief will be directed to the issues of both cases.

Dated this 29th day of March, 1957.

C. E. LUCKEY,

United States Attorney,
District of Oregon;

/s/ EDWARD J. GEORGEFF,
Assistant United States
Attorney;

JACOB, JONES & BROWN,

/s/ MORRIS J. GALEN.

So Ordered.

/s/ WILLIAM DENMAN,
Chief Judge;

/s/ WALTER L. POPE,

/s/ FREDERICK G. HAMLEY,
United States District Judges.

[Endorsed]: Filed April 1, 1957.

United States
COURT OF APPEALS
for the Ninth Circuit

L. H. PIERCE, Appellant

v.

UNITED STATES OF AMERICA, Appellee

UNITED STATES OF AMERICA, Appellant

v.

LENA L. PIERCE, Appellee

BRIEF FOR THE UNITED STATES

*On Appeals from the Judgments of the United States
District Court for the District of Oregon*

CHARLES K. RICE,
Assistant Attorney General.

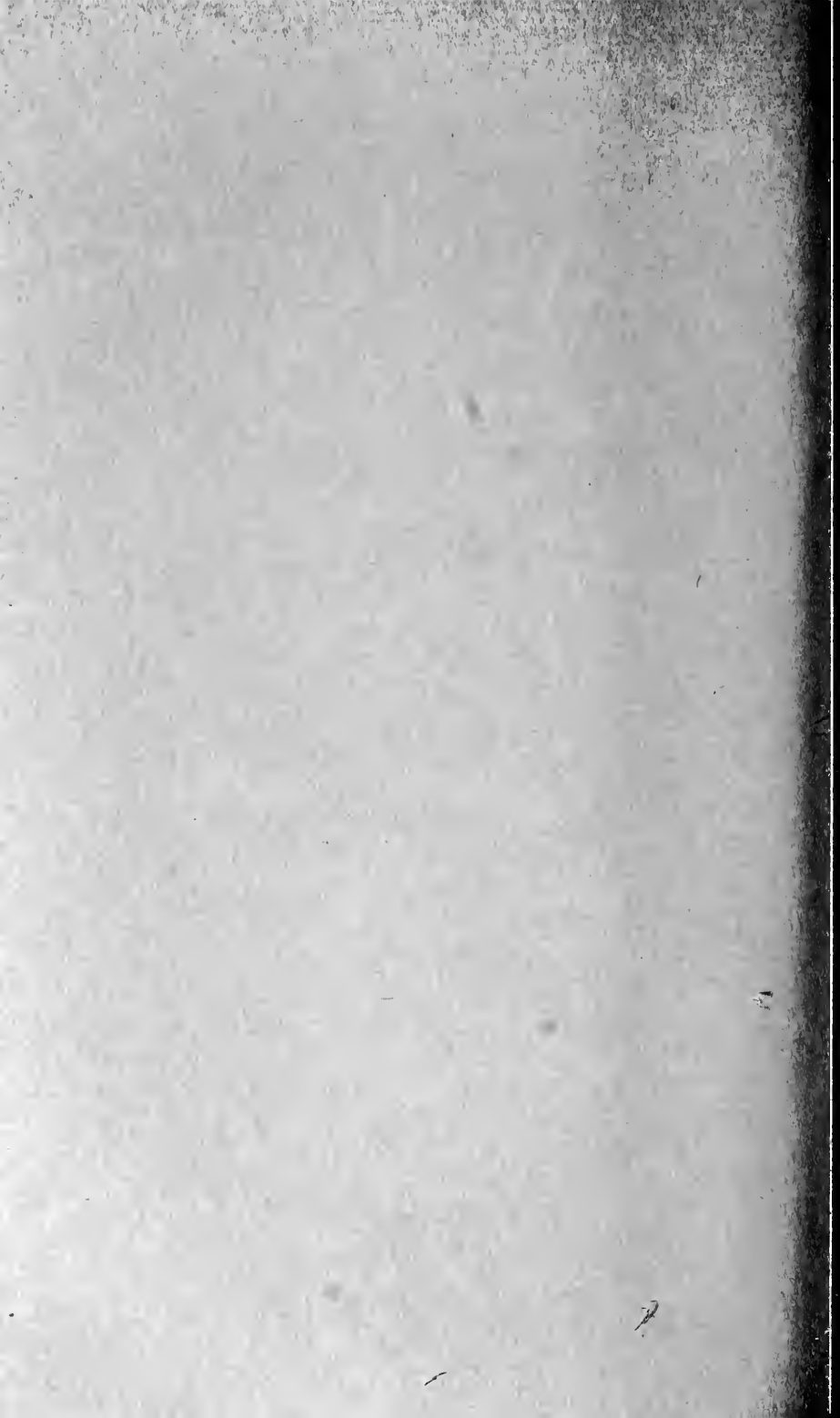
JOHN N. STULL,
I. HENRY KUTZ,
ARTHUR I. GOULD,
Attorneys,
Department of Justice,
Washington 25, D.C.

CLARENCE E. LUCKEY,
United States Attorney.

EDWARD J. GEORGEFF,
Assistant United States Attorney.

FILED

JUL 5 1957



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United States
COURT OF APPEALS
for the Ninth Circuit

No. 15,461

L. H. PIERCE, Appellant

v.

UNITED STATES OF AMERICA, Appellee

No. 15,462

UNITED STATES OF AMERICA, Appellant

v.

LENA L. PIERCE, Appellee

*On Appeals from the Judgments of the United States
District Court for the District of Oregon*

BRIEF FOR THE UNITED STATES

OPINION BELOW

The District Court rendered no opinion; its findings of fact and conclusions of law are to be found at R. 25-31.

JURISDICTION

These consolidated appeals involve federal income taxes, and taxpayers are respectively husband and wife. The taxes in dispute for the taxable year 1946 were returned and paid on or about March 15, 1947. (R. 17-18.) Claims for refund were filed on June 7, 1949 (R. 20-21), and no decision was rendered by the Commissioner within the six months the claims were filed nor at any date thereafter. Within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on December 6, 1954, taxpayers brought actions in the District Court for recovery of taxes paid. (R. 3-8.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgments were respectively entered on October 29, 1956, in the case of L. H. Pierce in favor of the Government dismissing the complaint and in the case of his wife, Lena L. Pierce, in her favor in the amount of \$1,553.55 with interest. (R. 31-33.) Within sixty days and on December 5, 1956, notices of appeals were filed by the Government and L. H. Pierce from the judgments respectively adverse to each. (R. 34-35.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED

1. Whether salary income received by a taxpayer for his services as a corporate official represents income attributable to the operation of a trade or business regularly carried on by him for purposes of computation of the net operating loss deduction within the meaning of

Section 122(d)(5) of the Internal Revenue Code of 1939.

2. Whether the nature of the income reported one-half separately by a husband and wife as community property income is determined for both as attributable to the operation of a trade or business by the activities of the husband who produced the income.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [As added by Sec. 211(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction*.—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 122 [As added by Sec. 211(b), Revenue Act of 1939, *supra*; and amended by Sec. 105(e), Revenue Act of 1942, c. 619, 56 Stat. 798; Sec. 215(a), Revenue Act of 1950, c. 994, 64 Stat. 906]. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss*.—As used in this section, the term “net operating loss” means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-Back and Carry-Over*.—

(1) *Net operating loss carry-back*.—

(A) *Loss for Taxable Year Beginning Before 1950*.—If for any taxable year beginning after December 31, 1941, and before January

1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

(B) *Loss for Taxable Year Beginning After 1949.*—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year.

* * * * *

(d) *Exceptions, Additions, and Limitations.*—The exceptions, additions, and limitations referred to in subsections (a) (b), and (c) shall be as follows:

* * * * *

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions, additions, and limitations specified in paragraphs (1) to (4) of this subsection.

* * * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.122-3. *Computation of Net Operating Loss in Case of a Taxpayer Other Than a Corporation.*—(a) *General.*—A net operating loss is sustained by a taxpayer other than a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over gross income, both computed with the following exceptions and limitations:

* * * * *

(7) Ordinary nonbusiness deductions (i.e., exclusive of capital losses) shall be allowed only to the extent of the amount of ordinary nonbusiness gross income (i.e., exclusive of capital gains), plus (A) for any taxable year beginning after December 31, 1938, and before January 1, 1942, the excess, if any, of nonbusiness long-term and short-term capital gains over nonbusiness long-term and short-term capital losses, respectively, and (B) for any taxable year beginning after December 31, 1941, the excess, if any, of nonbusiness capital gains over nonbusiness capital losses.

* * * * *

STATEMENT

The findings of facts in the cases at bar (R. 25-29) were based on the stipulated facts contained in the pre-trial order (R. 14-24), where both actions were consolidated for trial (R. 15.) The facts may be summarized as follows:

The taxpayers, L. H. Pierce and Lena L. Pierce, are husband and wife who filed separate individual income

tax returns for the years in question, 1946 and 1948. Taxpayers were residents of Multnomah County, Oregon, and in accordance with the community property law of that state each taxpayer reported one-half of this total income as his or her individual share of the community property. (R. 25-26, 28.)

Both taxpayers kept their books and filed their returns on a calendar year and cash receipts and disbursement basis. For taxable year 1946 the taxpayer husband had gross income of \$66,662.26 and net income of \$65,790.16. For the same year the taxpayer wife had gross income of \$66,662.25 and net income of \$65,825.45. Both taxpayers filed their separate 1946 returns with the Collector of Internal Revenue, Portland, Oregon, on or about March 15, 1947, in the amount of \$36,456.66 for the husband and \$36,112.31 for the wife which each paid to the Collector. (R. 26-27.)

The taxpayers were equal partners in the L. H. Pierce Auto Service which was organized on January 1, 1935. Taxpayers shared profits and losses equally for taxable years 1935 through 1948, inclusive. Taxpayers each owned 50% of the issued and outstanding stock of the Pierce Trailer & Equipment Company, an Oregon corporation, organized on or about April 2, 1947. The partnership had engaged in the manufacture of trailers until the corporation was organized, at which time the latter organization conducted the trailer business. The partnership then leased property it owned to the corporation and conducted other operations not connected with the business of the corporation. (R. 27-28.)

For the taxable year 1948 the taxpayers had income and losses as follows: The partnership, L. H. Pierce Auto Service, sustained a net operating loss of \$4,193.12 reported as \$2,096.56 by each taxpayer on his or her separate 1948 federal income tax return; the corporation, Pierce Trailer & Equipment Company, paid the taxpayer husband \$6,000 for his services as president, which was reported as \$3,000 on the separate 1948 federal income tax return by each taxpayer; each taxpayer deducted \$3,391.47 on his or her separate 1948 tax return for his or her share of a nonbusiness casualty loss. (R. 28-29.)

On June 7, 1949, each taxpayer filed a separate claim for refund of taxes paid in 1946 in the amount of \$1,-553.55 with the Collector of Internal Revenue, Portland, Oregon. The claims were based upon an alleged overpayment in 1946 assertedly due to a net operating loss carry-back from 1948 in the amount of \$2,096.56 in each case resulting from the operation of the partnership. (R. 29.) The court below concluded that the taxpayer wife was entitled to the carry-back and relief in the full amount of her claim, and the taxpayer husband was not entitled to the carry-back and any relief upon his claim. (R. 29-31.) Judgments were rendered accordingly (R. 31-33), and these cross appeals followed.

STATEMENT OF POINTS TO BE URGED

The points to be urged by the United States in its appeal from the judgment in favor of the wife, Lena L. Pierce, are as follows:

1. The District Court erred in holding that where the activities of her husband in 1948 were sufficient to constitute the operation of a trade or business and where, under the community property law of Oregon, one-half of the income attributable to the operation of such trade or business was reported by taxpayer wife on her 1948 individual federal income tax return, that such income did not constitute trade or business income to taxpayer wife.

2. The District Court erred in holding that taxpayer wife, in the computation of the net operating loss deduction under Section 122(a) and (d)(5) of the Internal Revenue Code of 1939 for the year 1946, was entitled to treat as nonbusiness income the amount reported by her in 1948 which was attributable to the activities of her husband in the operation of a trade or business.

3. The District Court erred in holding that taxpayer wife was entitled to a deduction for the year 1946 under Section 23(s) of the Internal Revenue Code of 1939 in the amount of \$2,096.56 as a net operating loss carry-back from the year 1948.

SUMMARY OF ARGUMENT

The taxpayers, husband and wife, filed separate income tax returns for the year 1948 and under the community property law of Oregon she reported one-half of the items here in issue as her share of the community property. In that year they equally incurred a nonbusiness casualty loss and a business net operating loss from

a partnership they owned equally. In addition, the husband received salary for services performed as a corporate official in a corporation they owned equally. Taxpayers claimed a net operating loss deduction by carrying back the loss on the partnership to year 1946. They claimed that the salary was not income received from a business or trade and could therefore be offset against the nonbusiness casualty loss under Section 122(d)(5) of the Internal Revenue Code of 1939. The Government urged that salary income is income from a trade or business and under Section 122(d)(5) could not be offset by the nonbusiness casualty loss. The District Court held that the husband's share of his salary income was income from his trade or business; however, the wife's share of her spouse's salary was not income from trade or business.

On taxpayer husband's appeal, the Government contends that the District Court was correct in holding salary income to be income from a trade or business under the governing provisions of the Code. This precise issue has been recently decided in the affirmative by the Courts of Appeals for the Second and Third Circuits in addition to the Tax Court in construing Section 122(d)(5). Furthermore, any other decision would frustrate the intent of Congress.

On its appeal the Government urges that the District Court erred in holding the wife's share of her husband's business income as community property was not also business income to her. The Government contends that under the community property law the nature of the income is determined by activities of the spouse per-

forming the service. Since the District Court decided the salary was income from a trade or business in the hands of the husband, it is the same in the hands of the wife. This position finds ample support in the authorities.

ARGUMENT

I

**Salary Income Received by Taxpayer for His Services
as a Corporate Official Represents Income Attributable
to the Operation of a Trade or Business Regularly
Carried on by Him for Purposes of Computing the
Net Operating Loss Deduction Within the Meaning of
Section 122(d)(5) of the Internal Revenue
Code of 1939**

The instant cases have been consolidated for submission to this Court. In the court below the taxpayer wife prevailed in her suit for refund of taxes paid in 1946, and the Government prevailed in the taxpayer husband's suit for refund of taxes paid in the same year. The losing party in each suit has appealed the decision of the lower court. In addition to the stipulation as to consolidation of the two cases for appeal, the parties have also stipulated that the Government would present the first brief to this Court. (R. 31-33, 34-35, 43-44.)

The facts in these cases are not in controversy. (R. 21, 25.) The District Court's findings of fact were derived from a pre-trial order that was based upon facts stipulated by the parties. (R. 14-21, 25-29.) Consequently, the questions presented to this Court are legal issues.

The taxpayers in the cases at bar are husband and wife residing in the State of Oregon. In accordance with the community property provisions of that state, the husband and wife have each reported for income tax purposes one-half of the total income of the spouses as his or her share of the community property for the years in question. The taxpayers were equal partners in a business engaged mainly in trailer manufacturing known as L. H. Pierce Auto Service. They each also owned 50% of the total issued and outstanding stock of the Pierce Trailer & Equipment Company, Inc., an organization formed in April, 1947, that supplanted the partnership in the trailer business activities. Thereafter, the partnership conducted business operations not connected with the activities of the corporation although it did lease property to the latter organization. (R. 25-28.)

In the taxable year 1946 the husband had reported on federal income tax return a gross income of \$66,662.26 upon which he paid a tax of \$36,456.66 and the wife had reported gross income of \$66,662.25 upon which she paid income tax in the amount of \$36,112.31. (R. 26-27.) During the taxable year 1948 the partnership had a net operating loss of \$4,193.12, each taxpayer reporting \$2,096.56 on his respective tax return for that year. In addition, the husband as its president received a salary of \$6,000 from the corporation which each taxpayer reported as \$3,000 on the 1948 return. Further, each taxpayer incurred and separately reported the amount of \$3,391.47 as a nonbusiness casualty loss on the same returns (R. 28-29.)

Taxpayers based their claims for refund on the provisions relating to net operating loss deductions as set forth in Sections 23(s) and 122 of the Internal Revenue Code of 1939, *supra*. Taxpayers had sought to avail themselves of the provision allowing a net operating loss carry-back. Specifically they claimed that their net operating loss of the partnership in 1948 should be offset against the 1946 income, thereby reducing the tax paid for the earlier year. Section 122(d)(5) of the Internal Revenue Code of 1939, *supra*, allows a taxpayer (other than a corporation), to make use of nonbusiness losses as a net operating loss carry-back only to the extent of his gross income in the same year not derived "from the operation of a trade or business regularly carried on by the taxpayer." It is admitted (R. 19) and the court below found (R. 28-29) that the casualty loss sustained in 1948 by each of the taxpayers in the amount of \$3,391.47 was a nonbusiness casualty loss. Hence, for purposes of computation of a net operating loss, it could be utilized within the mandate of Section 122(d)(5) only to the extent of gross income not attributable to the operation of a trade or business regularly carried on by taxpayer. Taxpayers' contention is that the salary which taxpayer husband, L. H. Pierce, received as president of the corporation, Pierce Trailer & Equipment Company, Inc., was not derived from trade or business and, hence, the casualty loss was allowable under Section 122(d)(5) as against the amount of \$3,000, or one-half of this salary reported by each of the respective taxpayers. This would leave the partnership loss, as a business loss, reported by each in the amount of \$2,096.56 to be carried back as a net operating loss.

On the other hand, if, as the Government contends to be correct, the \$3,000 of salary income reported by each taxpayer is income attributable to the operation of a trade or business then the amount of the nonbusiness casualty loss cannot be set off against it in computation of the net operating loss and cannot be used in computation of the net operating loss of either taxpayer. Moreover, if the Government's contention is correct, it further follows that there is no net operating loss at all to be carried back in the case of either taxpayer, since the partnership loss is less than the \$3,000 business income, inuring to each member of the marital community, from the \$6,000 salary paid to the taxpayer husband.

In the case of taxpayer husband the District Court agreed with the Government's contention and decided that, in the computation of the net operating loss deduction under Section 122 of the 1939 Code, the \$3,000 received and reported by him from the corporation was received by him in the operation of a trade or business and must be offset against his distributable share of the partnership loss in the amount of \$2,096.56 and, accordingly, held taxpayer husband is not entitled to any net operating loss deduction for 1946 and his complaint must be dismissed. (R. 29-30.) On this issue the taxpayer husband has appealed to this Court. On the other hand the District Court also held that \$3,000 reported by the wife under the Oregon community property law, representing one-half of the salary paid by the corporation for his services as president (R. 30), "did not constitute income to her from her trade or business." Consequently, the lower court held this amount could be

offset against the nonbusiness casualty loss with the further result that her share of the \$2,096.56 partnership loss for 1948 could be carried back as a net operating loss to 1946 and offset against her 1946 income. (R. 30-31.) The Government disputes this conclusion and, accordingly, has appealed the judgment in taxpayer wife's favor (\$1,553.55 plus interest) based upon it. (R. 32-35.)

The Government respectfully submits that the court below was correct in holding that the salary received by taxpayer husband for services rendered as president of the corporation was income received in the operation of a trade or business within the meaning of Section 122 (d)(5).

The District Court's ruling in this connection in construction of Section 122(d)(5) is sustained by recent decisions of the Second and Third Circuits and the Tax Court which hold that a corporate officer or other employee who receives compensation in the form of a salary is engaged in a trade or business, namely, the trade or business of rendering services for pay. Therefore his salary is business income, and he may not deduct from it a nonbusiness loss in computing under Section 122 (d)(5) his net operating loss. *Overly v. Commissioner* (C.A. 3d), decided April 29, 1957 (1957 P-H, par. 72, 677); *Folker v. Johnson*, 230 F. 2d 906 (C.A. 2d); *Lagreide v. Commissioner*, 23 T.C. 508, overruling *Luton v. Commissioner*, 18 T.C. 1153;¹ *Wile v. Commissioner*, decided April 17, 1956 (1956 P-H T.C. Memorandum Decisions, par. 56,090); *Ranson v. Commissioner*, de-

¹ See, also, Rev. Rul. 55-600, 1955-2 Cum. Bull. 576.

cided June 30, 1952 (1952 P-H T.C. Memorandum Decisions, par. 52,213).

In holding salary to be income from a "trade or business regularly carried on by the taxpayer" the court reasoned in *Folker v. Johnson, supra* (pp. 908-909) as follows:

* * * where the purpose of the two statutory provisions is similar a consistent interpretation is desirable and equitable. In this instance we think a consistent interpretation is necessary in order to fully effectuate the not dissimilar purposes of both sections. It should be noted that the net operating loss defined in Section 122 is utilized in the statutory scheme by taking a deduction as provided in the deduction section of the Code, Section 23(s).

Salaried employees and corporate officers have been held to have been engaged in a trade or business under Section 23(a) on innumerable occasions.

* * *

* * * the corporation is an entity separate and apart from its officers and stockholders, and that its business is not the business of the officers.

Consequently, we hold that the plaintiff, who devoted his entire working time to his duties as a corporate officer and who received compensation in the form of a salary, was engaged in a trade or business—the trade or business of rendering services for pay. Therefore, his salary was business income, and he may not deduct from it non-business expenses in computing under Section 122(d)(5) his net operating loss for carry-back purposes.

As many of the cited cases have recognized, salaried employees and corporate executives have repeatedly been held to have been engaged in a trade or business within the meaning of Section 23(a) of the 1939 Code.

Daily Journal Co. v. Commissioner, 135 F. 2d 687 (C.A. 9th); *Hill v. Commissioner*, 181 F. 2d 906 (C.A. 4th); *Hochschild v. Commissioner*, 161 F. 2d 817 (C.A. 2d); *Marsch v. Commissioner*, 110 F. 2d 423 (C.A. 7th); *Washburn v. Commissioner*, 51 F. 2d 949 (C.A. 8th). Substantially the same language contained in Section 122(d)(5) should be afforded the same meaning.

Cases which deny attempted deductions by corporate officers and stockholders of losses resulting from isolated loans to or investments in corporations in which they have a financial interest are not in point. They hold only that a taxpayer to sustain such a claimed deduction must show that it occurred in a separate business of his own; it is not enough for him to show that the loss occurred in the business of the corporation.² Indeed, as the Second Circuit pointed out in the *Folker* case, these authorities support the Government's position rather than that of the taxpayer, since they indicate that the corporation is an entity separate and apart from its officers and its stockholders and its business is not the business of its officers.

Moreover, the construction afforded Section 122(d)(5) by the District Court carries out the general purpose of the net operating loss deduction. Both the Senate and the House pointed out that the general purpose of the net operating loss provision was to equalize taxes. See S. Rep. No. 648, 76th Cong., 1st Sess., p. 1 (1939-2 Cum. Bull. 524); H. Rep. No. 855, 76th Cong., 1st Sess.,

² *Dalton v. Bowers*, 287 U.S. 404; *Burnet v. Clark*, 287 U.S. 410; *Miller v. Commissioner*, 102 F. 2d 476 (C.A. 9th).

p. 9 (1939-2 Cum. Bull. 504, 510). In view of this policy a narrow interpretation of the clause "trade or business" in the net operating loss provision would leave a taxpayer earning net income from his salary in an inequitable position, for, as the court pointed out in the *Folker* case, *supra* (p. 908), it would be inequitable to interpret the phrase "trade or business" in such a fashion that salaried employees, professional men and others would not be dealt with under Section 122 in the same manner as persons receiving income from a sole proprietorship.

On the other hand the net operating loss deduction is particularly concerned with losses resulting from business operations and, hence, Congress limited the deduction in Section 122(d)(5) by providing that deductions otherwise allowed by law, but not attributable to the operation of a trade or business, should be allowed only to offset income which was not connected with business activities.

The decision of this Court in *McGinn v. Commissioner*, 76 F. 2d 680 (1935), construed language of earlier Revenue Acts dealing with net losses and in particular Section 204(a) of the Revenue Act of 1921, c. 136, 42 Stat. 227, which defined net loss to be "only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer." Taxpayer was a corporate officer of a bank and the loss occurred (p. 681) "because as such officer of the bank he disposed of the property of the bank in violation of the law and was compelled to reimburse the bank for the loss." This Court held this loss was not deductible as a net loss, since not resulting from the operation of any trade or

business regularly carried on by the taxpayer. This holding may be distinguishable from the case at bar on the ground that the loss there was not proximately related to the occupation of being a corporate officer, but occurred rather in the separate business of the corporation itself. Taxpayer, having caused the loss in the corporate business, was required to make it good. Moreover, the Court there cited *Dalton v. Bowers, supra*, and *Burnet v. Clark, supra*, and the accepted reading of those cases today, discussed above, namely, that they involved isolated loans to and investments in corporations, not amounting to a trade or business, may not have been as plain twenty-two years ago. Nevertheless, some of the language contained in the opinion in the *McGinn* case is inconsistent with the recent holdings of the Second and Third Circuits and of the Tax Court, cited above, and to that extent, it is respectfully requested that this Court adopt the reasoning of these recent cases³ and which inferentially the court below felt it was not inhibited by any decision of this Court from adopting.

³ See comment on the *McGinn* case by the Second Circuit in the *Folker* case (p. 908) and on *Hughes v. Commissioner*, 38 F. 2d 755 (C.A. 10th) (1930), by the Third Circuit in the *Overly* case, *supra*, and the Second Circuit in the *Folker* case (p. 908).

II

**Under Community Property Law the Nature of Income
Reported Separately by a Husband and Wife Is De-
termined for Both as Attributable to the Operations of
a Trade or Business by the Activities of the Husband,
Who Produced the Income**

The District Court concluded in regard to the taxpayer wife that the \$3,000 reported by her under the community property law of Oregon on her 1948 federal income tax return which represented one-half of the salary paid to her husband did not constitute income to her from her trade or business. (R. 30.) Consequently, the wife was allowed to offset her share of the husband's salary against the nonbusiness casualty loss and therefore carry back to 1946 her share of the partnership net operating loss of 1948. The Government respectfully urges that the court below erred in arriving at this conclusion of law. The Government contends that in a community property jurisdiction the nature of the income—that is, whether it is or is not income from a trade or business—is determined by the activities of the spouse who produced the income.

The Oregon Community Property Act under which the husband and wife taxpayers filed their separate 1948 tax returns (R. 25) was put into effect on July 5, 1947, and was repealed on April 11, 1949, and thus was in force during 1948. (Oregon Laws of 1947, c. 525; Oregon Laws of 1949, c. 349.) It is not disputed that the community property system was imposed on married persons, such as these taxpayers, domiciled in Oregon during 1948. I.T. 3868, 1947-2 Cum. Bull. 49.

It had long been recognized that the community property relation between husband and wife created a situation in which the spouse earning the income acted as an agent for the community. *Poe v. Seaborn*, 282 U.S. 101. Another explanation of the community property relation is that it is a partnership with each spouse having equal rights in the property and the income of that property. *Goodell v. Koch*, 282 U.S. 118; *Bender v. Pfaff*, 282 U.S. 127. The rights of one spouse in the community property is perfectly equivalent to the rights of the other spouse. *Hopkins v. Bacon*, 282 U.S. 112. Recognizing the legal effect of the community property relationship, it cannot be said that the spouse earning the income for the community has income of a different nature than the other spouse. The nature of the income for both members of the partnership is determined when the income is earned.

A striking analogy is presented by authority holding that where a spouse earned income that was tax exempt the community share reported by his spouse was also exempt from taxation. This situation is made very clear in *Kaufman v. Commissioner*, 9 B.T.A. 1180. In that case the husband was employed by the State of Louisiana, a community property state. Income of that nature was then exempt from federal income taxation under the Revenue Act of 1921, c. 136, 42 Stat. 227. The Commissioner attempted to tax one-half of this income, being the wife's share of the community, on the basis that since the wife was not employed by the State the income lost its exempt status in the hands of the wife.

The Board of Tax Appeals (now the Tax Court) answered this contention as follows (p. 1182):

This contention is based upon an erroneous conception of community income. The earnings of the husband from personal services become immediately a part of the community. Any exemption from taxation in relation to those earnings immediately attaches to the total amount, and whatever right the wife may have to report one-half thereof can not affect its taxable status and convert into taxable income that which was exempt when it came into the community.

Other authorities illustrating that the division of income on the community property basis does not alter the exempt character of income entitled to exemption are: *Markham v. United States* (S.D. Calif.), decided June 23, 1953 (45 A.F.T.R. 1143); *Mullen v. Commissioner*, 14 T.C. 1179; I.T. 3665, 1944-1 Cum. Bull. 161; Rev. Rul. 54-16, 1954-1 Cum. Bull. 157; Rev. Rul. 55-246, 1955-1 Cum. Bull. 92.

This Court has already decided whether or not the nature of the income in the hands of the spouse reporting her share under the community property system is any different than that in the hands of the spouse whose activities earned the income. In *Graham v. Commissioner*, 95 F. 2d 174, this Court was faced with the question of whether the wife's half of the community income derived from the husband's architectural fees was "Earned income" within the meaning of Section 31 of the Revenue Act of 1928, c. 852, 45 Stat. 791. This section allowed a taxpayer a credit for a percentage of his "Earned income" which in this specific case would be professional fees received as compensation for personal

services actually rendered. The Government conceded that the husband's share of the income earned for the community was "Earned income" but it contended that the wife's share was not because she did not actually render any personal services.⁴

This Court rejected the Government's contention and held (p. 176):

The Board found that said community income was received as compensation for professional services rendered by petitioner's husband. Respondent assumes, erroneously, that these services were rendered by petitioner's husband individually, on his own account and for himself alone, thus assuming as a fact that which, in Washington, is a legal impossibility. When a married man residing in Washington practices a profession or engages in any gainful occupation or activity, he does so as the agent of a marital community consisting of himself and his wife. *Poe v. Seaborn, supra*. He cannot do so in any other way or in any other capacity. *Services rendered by him are actually rendered by the community, that is to say, by him and his wife, equally. So, in this case, petitioner was, no less than her husband, the actual renderer of the services for which they received as compensation the community income above referred to.*

That petitioner did not personally participate in the professional labors of her husband is immaterial. One may actually render a personal service without personally performing the acts constituting the service. Otherwise a partnership acting through one of its members, or a principal acting through an agent, could not actually render a personal service, the truth being, of course, that such services can be

⁴ A case in another circuit with facts similar to the *Graham* case, *supra*, and arriving at the same decision, is *McLarry v. Commissioner*, 30 F. 2d 789 (C.A. 5th).

and, in countless instances, are actually so rendered. (Italics supplied.)

The reasoning of this Court is equally applicable to the cases at bar. Taxpayer husband received income for his services that was income of the community of which he was an agent. The nature of the income of the community was determined when it was earned. Consequently, if the lower court is sustained on Point I, *supra*, that salary income of taxpayer husband is income from a trade or business it follows that the entire salary income earned for the community is income from a trade or business. The income in the hands of the wife representing her share of the community property is determined by the activities of the husband who produced the income. It is all business income.

CONCLUSION

For the reasons above given the judgment of the District Court for the defendant and dismissing the complaint should be affirmed in the case of taxpayer husband (*L. H. Pierce v. United States*), and the judgment of the District Court against the defendant in the sum of \$1,553.55 with interest should be reversed and judgment directed for the defendant and the complaint dismissed in the case of the taxpayer wife on the Government's appeal (*United States v. Lena L. Pierce*).

Respectfully submitted,

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JULY, 1957.

No. 15464

United States
Court of Appeals
for the Ninth Circuit

*See Vol.
3020*

RICHARD E. BENNETT,

Appellant,

VS.

ARCTIC INSULATION, INC., and DELBERT
E. BOYER,

Appellees.

Transcript of Record

Appeal from the District Court for the District of Alaska,
Fourth Judicial District

FILED

APR 19 1957

PAUL P. O'BRIEN, CLERK



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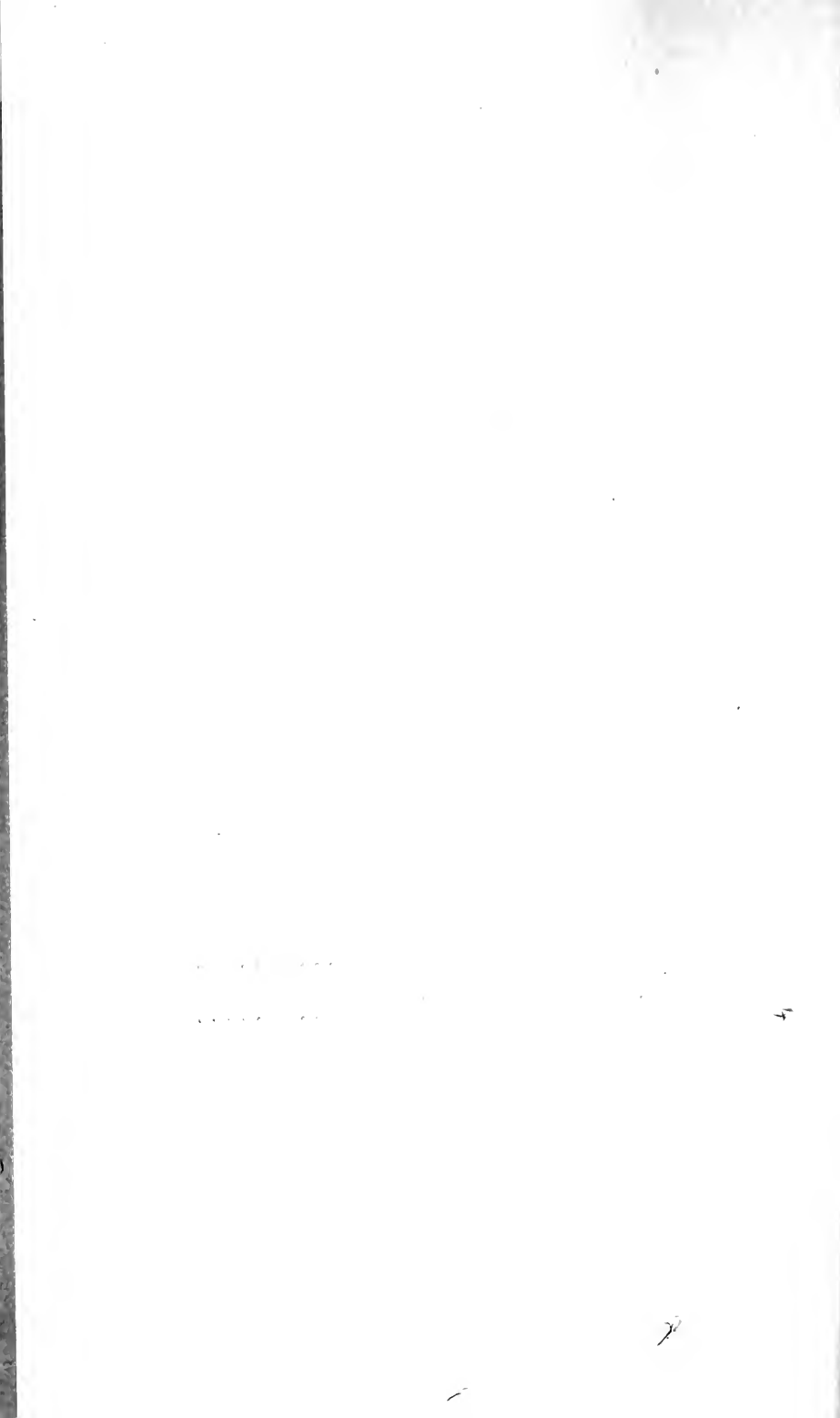
Transcript of Record

Appeal from the District Court for the District of Alaska,
Fourth Judicial District

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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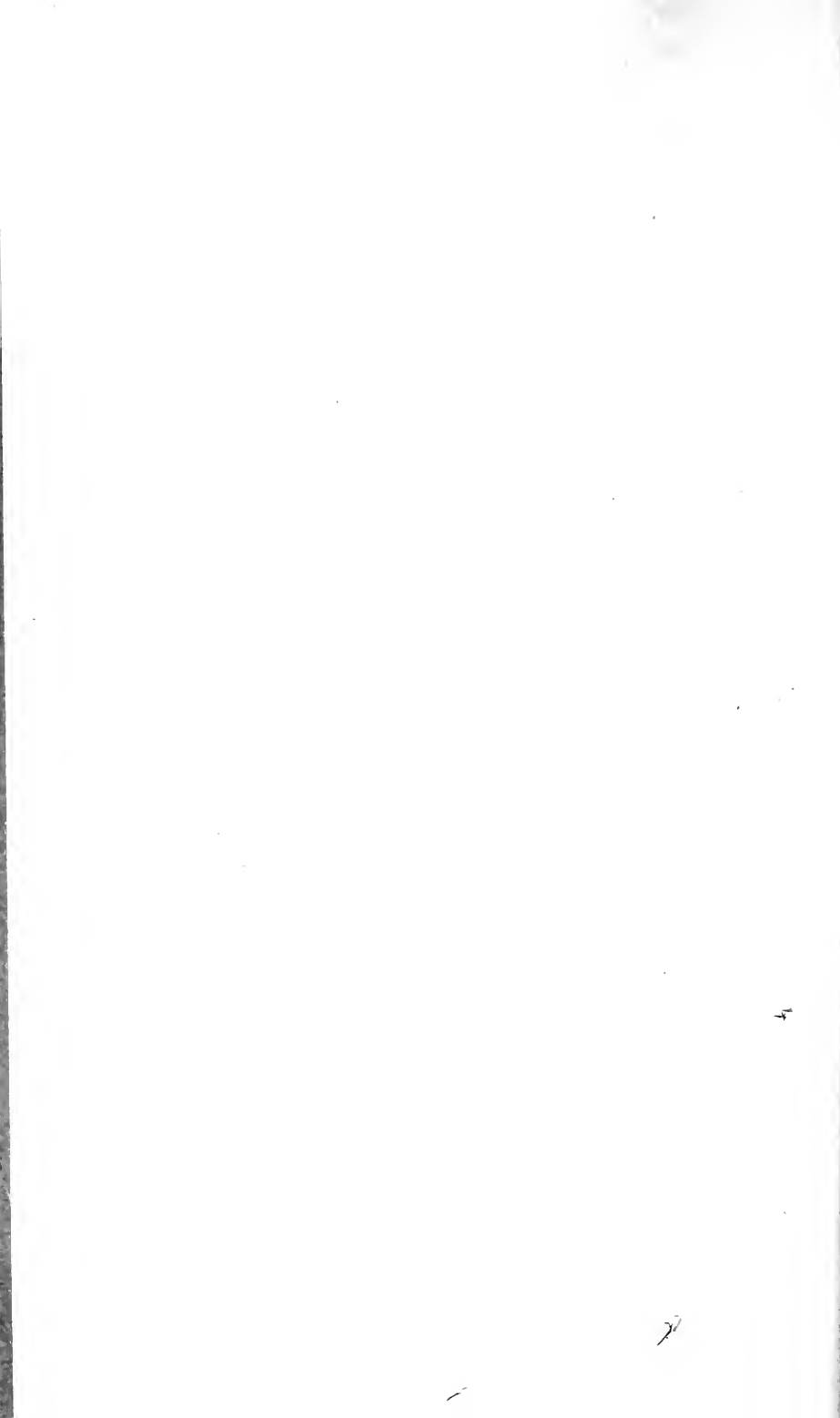
ATTORNEYS OF RECORD

ROBERT A. PARRISH,
544½ Second Ave.,
Fairbanks, Alaska,

Attorney for Plaintiff and Appellant.

CHAS. J. CLASBY,
MARY ALICE MILLER,
1000 Polaris Building,
Fairbanks, Alaska,

Attorneys for Defendants and Appellees.



In the District Court for the District
of Alaska, Fourth Division

No. 9254

RICHARD E. BENNETT,

Plaintiff,

vs.

ARCTIC INSULATION, INC., and DELBERT
E. BOYER,

Defendants.

COMPLAINT

Comes now, the above-named plaintiff, and for cause of action against the above-named defendants, complains and alleges:

I.

That on the 3rd day of October, 1954, plaintiff was operating a motor vehicle on the Richardson Highway near Fairbanks.

II.

That the defendant, Arctic Insulation, Inc., was, on the 3rd day of October, 1954, the owner of a certain 1953 Ford pickup vehicle.

That on said day the defendant, Delbert E. Boyer, agent acting within the scope of his employment, did negligently, and carelessly leave, unlocked, the said vehicle with the keys therein and unattended at Fairbanks, Alaska; that he did so in the area of several night clubs at South Fairbanks, Alaska.

That said Delbert E. Boyer, defendant, knew or should have known or should have reasonably fore-

seen that the vehicle was left in such a place where the same might be removed without consent or authority and that plaintiff might be damaged thereby.

III.

That on said day, one William F. Harris, a soldier or airman in the United States Service, did steal or assume possession of the said vehicle from the place where the same was left unattended and did carelessly and negligently drive the same on the Richardson Highway to a place about one hundred (100) feet from an intersection where a road known as the Badger Road intersects a public highway of the Territory of Alaska, known as the Richardson Highway, and did at said time and place, carelessly and negligently cause the said stolen vehicle to strike the automobile which plaintiff was driving, causing the injuries hereinafter described which were the direct and proximate result of said defendants' negligence as aforesaid.

IV.

That as a result of the premises hereinafter set out and as a direct and proximate result of the wilful, reckless, careless and negligent conduct of the defendants as aforesaid, plaintiff suffered great and severe temporary and permanent injuries of his legs, arm, back, head, face and eyes and that his system in general was completely disabled for a long period of time and will be permanently disabled and he did suffer cuts, bruises, contusions and fractures over various parts of his body and was hospitalized for a long period of time and at

intervals and did incur hospital expenses in excess of Three Thousand (\$3,000.00) Dollars, and in the future will require further hospitalization of an approximate value of Five Thousand (\$5,000.00) Dollars, or more to repair his eyes and eyesight and that he has become indebted for doctor bills of a reasonable value of Two Thousand, Five Hundred (\$2,500.00) Dollars, or more, and nursing expenses of a reasonable value of Two Thousand (\$2,000.00) Dollars; that plaintiff has been totally disabled in the past and will be partially disabled for the rest of his life; that he has lost wages and earnings and will in the future lose wages, earnings and emoluments and that as a direct result of the said negligent acts of the defendants, plaintiff is and has been damaged in the sum of Two Hundred Fifty Thousand (\$250,000.00) Dollars.

Wherefore, Plaintiff prays for judgment of and from the defendants and each of them for the sum of Two Hundred Fifty Thousand (\$250,000.00) Dollars, in addition to plaintiff's costs, disbursements, attorney's fees and fees incurred herein and accruing costs, fees and interest.

Dated at Fairbanks, Alaska, this 27th day of September, 1956.

/s/ ROBERT A. PARRISH,
Attorney for Plaintiff.

Duly Verified.

[Endorsed]: Filed September 28, 1956.

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes now the defendant, Arctic Insulation, Inc., a corporation, by its attorneys, Collins, Clasby and Sczudlo, and moves that the above-entitled cause and the complaint filed therein be dismissed upon the ground and for the reason that the complaint fails to state facts sufficient to constitute a claim for relief against this defendant for the following reasons: (a) no acts of negligence of this defendant sufficient to support said cause are alleged; (b) no purported negligence of this defendant constituted the proximate cause of the personal injuries alleged to have been suffered by the plaintiff; (c) the personal injuries, if any, suffered by plaintiff were caused by the negligence of William F. Harris, who stole or assumed possession, without authority, of the vehicle described in the complaint; and (d) that the defendant Delbert E. Boyer was not acting within the scope of his employment and was not the agent of this defendant at the time of the accident alleged in the complaint, or at the time that the vehicle described in the complaint, owned by this defendant, was stolen or unauthorized possession thereof taken by William F. Harris.

Dated at Fairbanks, Alaska, this 13th day of November, 1956.

COLLINS, CLASBY AND
SCZUDLO,

By /s/ WALTER SCZUDLO,
Attorneys for Defendant,
Arctic Insulation, Inc.

Receipt of copy acknowledged.

[Endorsed]: Filed November 13, 1956.

[Title of District Court and Cause.]

ORDER GRANTING MOTION TO DISMISS

This Cause coming on regularly to be heard before the undersigned judge of the above-entitled court on December 7, 1956, upon the motion of the Defendant Arctic Insulation, Inc., to dismiss the above-entitled action, and the court having examined and considered the pleadings, the briefs of the parties in support of and in opposition to such motion, and the records and files in Cause No. 9072, Richard E. Bennett, Administrator of the Estate of Evelyn E. Bennett, deceased, vs. Arctic Insulation, Inc., et al., to which reference is made in the briefs in this cause, together with the additional authorities now submitted by plaintiff in support of the complaint; and it appearing to the court that the plaintiff has failed to state a claim upon which the relief sought can be granted, and that the sufficiency of the allegations of the complaint to constitute negligence and proximate cause are questions of law for the court and not questions of fact for a jury;

Now Therefore in accordance with the decision of the Honorable Vernon D. Forbes, judge of this court, in Cause No. 9072,

It is Ordered that the motion of the defendant is granted and that the within cause of action be and is hereby dismissed.

Dated at Fairbanks, Alaska, this 26th day of December, 1956.

/s/ WALTER H. HODGES,
District Judge.

[Endorsed]: Filed and entered December 26, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Richard E. Bennett, Plaintiff above named, hereby appeals to the Court of Appeals for the Ninth Circuit from the Order Granting Motion to Dismiss entered in this action on December 26, 1956.

Dated at Fairbanks, Alaska, this 16th day of January, 1957.

/s/ ROBERT A. PARRISH,
Attorney for Plaintiff-
Appellant.

Receipt of copy acknowledged.

[Endorsed]: Filed January 23, 1957.

[Title of District Court and Cause.]

BOND ON APPEAL

Whereas, the plaintiff in the above-entitled action, Richard E. Bennett, has this day filed with the District Court for the District of Alaska, Fourth Division, his notice of appeal from the Order Granting Motion to Dismiss entered on December 26, 1956, in favor of the Defendant,

Now, therefore, in consideration of the premises and of such appeal, we Richard E. Bennett, as principal, and Martha Hoeckle and William R. Whitcher, as sureties, do hereby undertake and promise and do acknowledge ourselves bound unto the defendants in the sum of Two Hundred Fifty and No/100ths Dollars (\$250.00), conditioned for the payment of the costs on appeal, if the appeal is dismissed or the said order affirmed, or of such costs as the appellate Court may award if the judgment is modified.

Dated this 24th day of January, 1957.

/s/ RICHARD E. BENNETT,
Plaintiff, Principal.

/s/ MARTHA HOECKLE,

/s/ WM. R. WHITCHER,
Sureties.

United States of America,
Territory of Alaska—ss.

William R. Whitcher, of 1015 Eighth Avenue, Fairbanks, Alaska, and Martha Hoeckle, of 202 Second Avenue, Fairbanks, Alaska, each being duly sworn, upon oath state the following:

I am a resident of the Territory of Alaska, and my address is as stated immediately above. This affidavit is made for the purpose of justifying as Surety on the foregoing Bond on Appeal, the obligation thereunder being in the amount of Two Hundred Fifty and no/100 (\$250.00) Dollars. I am worth in excess of said sum above all exemptions allowed by law. I am aware that in the event of the breach of the conditions of said Bond on the part of plaintiff, I will be required to pay to the United States of America the penal sum thereof.

I am not a Counselor or Attorney at Law, Marshal, Deputy Marshal, Commissioner, Judge, Clerk of Court or other person prohibited by law from acting as such surety.

/s/ WM. R. WHITCHER,

/s/ MARTHA HOECKLE.

Subscribed and sworn to before me this 24th day of January, 1957.

[Seal]: /s/ ROBERT A. PARRISH,
Notary Public in and for the Territory of Alaska.
My Commission expires February 9, 1960.

Receipt of copy acknowledged. 7

[Endorsed]: Filed January 24, 1957.

In the District Court for the District
of Alaska, Fourth Division

No. 9254

RICHARD E. BENNETT,

Plaintiff,

vs.

ARCTIC INSULATION, INC., and DELBERT
E. BOYER,

Defendants.

FINAL ORDER OF DISMISSAL
AND JUDGMENT

This matter coming on for hearing upon motion of the defendant Arctic Insulation, Inc., to dismiss the above-entitled action and upon said defendant's motion for costs and attorneys' fees; and the court having examined the files in the above cause and proceedings therein, and the briefs filed in said cause, and having heard statements of counsel and being otherwise fully advised in the premises; and it appearing and the court finding that it granted said defendant's motion to dismiss by its order entered December 26, 1956;

It is now, therefore, Ordered, Adjudged and Decreed as follows:

1. That the defendant, Arctic Insulation, Inc.'s, motion to dismiss the complaint filed herein and this action be and it is hereby granted, and said

complaint and this action be and they are hereby dismissed.

2. That said defendant's motion for costs and attorneys' fees be and it is hereby granted, and reasonable attorneys' fees incurred by said defendant be and they are hereby assessed in the sum of \$300.00, and allowed to said defendant as costs, and the clerk is hereby directed to enter as additional costs in favor of said defendant any costs incurred by it, as may be disclosed by any cost bill duly filed by said defendant, and judgment therefor against Richard E. Bennett, the plaintiff herein, be and it is hereby entered.

3. That pursuant to stipulation of the parties to this action made in open court, the above and foregoing order and judgment be and it is hereby entered nunc pro tunc December 26, 1956.

4. That pursuant to stipulation of parties made in open court, the clerk of this court be and he is hereby directed to include a copy of this order and judgment in the record on appeal being prepared in this cause in lieu of the order granting motion to dismiss entered herein on December 26, 1956.

Done and entered this 8th day of February, 1957.

/s/ VERNON D. FORBES,
District Judge.

Receipt of Copy acknowledged.

Lodged January 31, 1957.

[Endorsed]: Filed and entered February 8, 1957.

[Title of District Court and Cause.]

STATEMENT OF POINTS ON APPEAL

Comes Now, Richard E. Bennett, plaintiff, by and through his attorney, Robert A. Parrish, and itemizes his statement of points on appeal as follows:

That the Court erred by its order of December 26, 1956, in granting the motion to dismiss of the above-named defendants.

Dated at Fairbanks, Alaska, this 12th day of February, 1957.

/s/ ROBERT A. PARRISH,
Attorney for Plaintiff.

Receipt of Copy acknowledged.

[Endorsed]: Filed February 12, 1957.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, John B. Hall, Clerk of the above-entitled Court do hereby certify that the following list comprises all of the proceedings in this cause listed on the Designation of Record on appeal of the plaintiff and appellant, viz.:

- 1—Plaintiff's Complaint.
- 2—Motion to Dismiss.
- 3—Order granting Motion to Dismiss.
- 4—Plaintiff's Notice of Appeal.

5—Bond on Appeal.

6—Final Order of Dismissal and Judgment.

7—Statement of Points on Appeal.

8—Designation of Contents of Record on Appeal.

Witness my hand and the seal of the above-entitled Court this 28th day of February, 1957.

[Seal] /s/ JOHN B. HALL,
Clerk of Court.

[Endorsed]: No. 15464. United States Court of Appeals for the Ninth Circuit. Richard E. Bennett, Appellant, vs. Arctic Insulation, Inc., and Delbert E. Boyer, Appellees. Transcript of Record. Appeal From the District Court for the District of Alaska, Fourth Judicial Division.

Filed: March 6, 1957.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

7'

No. 15468

United States
Court of Appeals
for the Ninth Circuit

JOSE RAMIREZ, MEYER GOODMAN, MI-
CHAEL GULLON, BILL H. FREEMAN and
ROBERT E. MILLER,

Appellants,

vs.

REFUGIO GONZALEZ LOZOYA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the
Southern District of California,
Central Division.

FILED

AUG - 5 1957

PAUL P. O'BRIEN, CLERK



No. 15468

United States
Court of Appeals
for the Ninth Circuit

JOSE RAMIREZ, MEYER GOODMAN, MI-
CHAEL GULLON, BILL H. FREEMAN and
ROBERT E. MILLER,

Appellants,

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REFUGIO GONZALEZ LOZOYA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the
Southern District of California,
Central Division.

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NAMES AND ADDRESSES OF ATTORNEYS

For Appellant:

LAUGHLIN E. WATERS,

U. S. Attorney;

LOUIS LEE ABBOTT,

Asst. U. S. Attorney,

Chief, Criminal Division;

JOSEPH F. BENDER,

Asst. U. S. Attorney,

600 Federal Building,

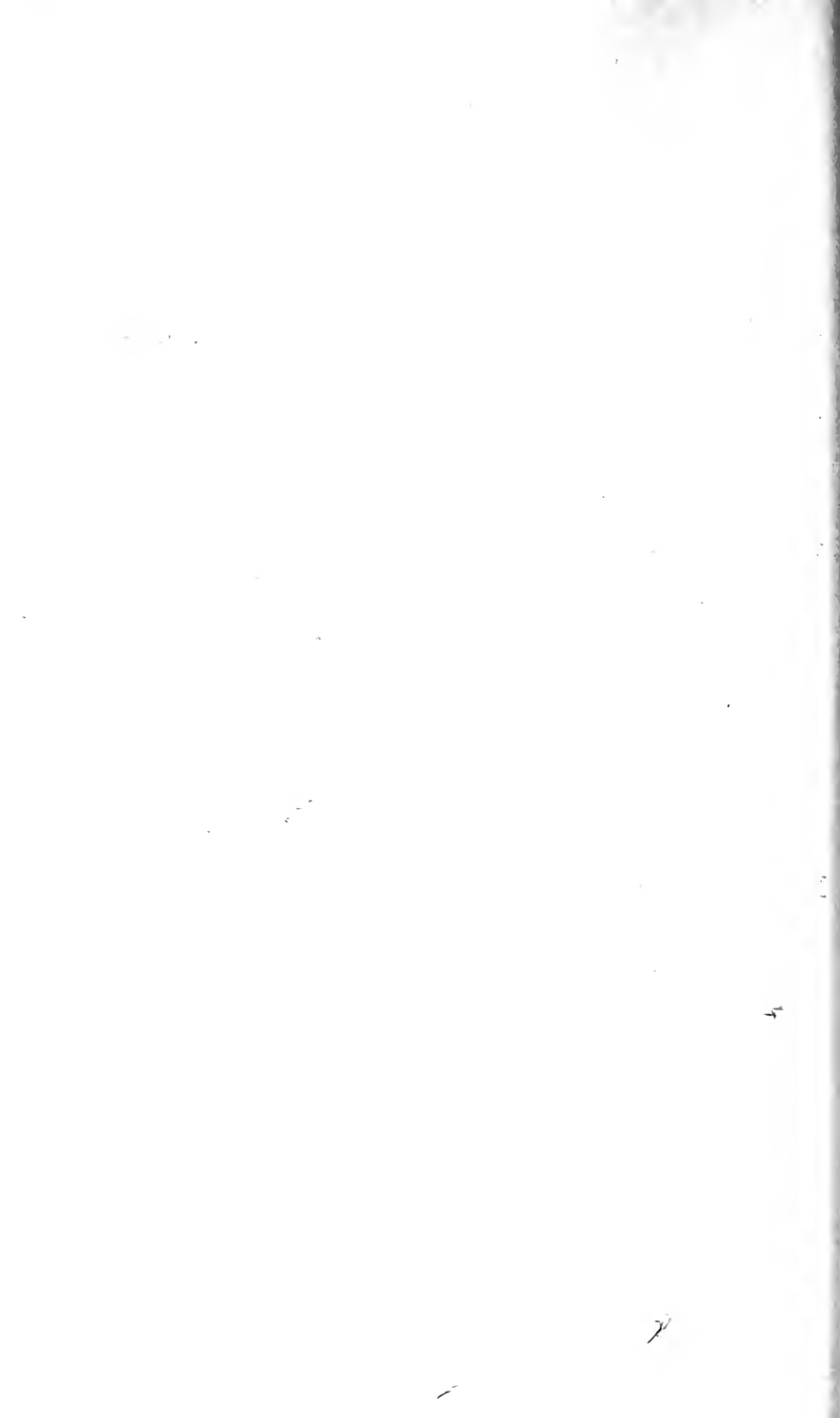
Los Angeles 12, California.

For Appellee:

DAVID C. MARCUS,

215 West Fifth Street,

Los Angeles, California.



United States District Court for the Southern
District of California, Central Division

No. 25033

UNITED STATES OF AMERICA,

Plaintiff,

vs.

REFUGIO GONZALEZ LOZOYA,

Defendant.

INDICTMENT

[U.S.C., Title 26, Secs. 4742(a) and 4744(a)—
Illegal Transfer, Acquisition of Marihuana]

The grand jury charges:

Count One

[U.S.C., Title 26, Sec. 4742(a).]

On or about May 17, 1956, in Los Angeles County, California, within the Central Division of the Southern District of California, defendant Refugio Gonzalez Lozoya did knowingly and unlawfully transfer approximately nine and one-half pounds of marihuana to another without obtaining a written order on a form issued for that purpose by the Secretary of the Treasury of the United States. [2*]

Count Two

[U.S.C., Title 26, Sec. 4744(a)]

On or about May 17, 1956, in Los Angeles County, California, within the Central Division of the South-

*Page numbering appearing at foot of page of original Certified Transcript of Record.

ern District of California, defendant Refugio Gonzalez Lozoya, being a transferee required to pay the transfer tax imposed by Section 4741(a), Title 26, United States Code, did knowingly and unlawfully acquire and obtain approximately nine and one-half pounds of marihuana without having paid such tax.

A True Bill,

/s/ RICHARD STEPHENSON,
Foreman.

/s/ LAUGHLIN E. WATERS,
United States Attorney.

[Endorsed]: Filed May 29, 1956. [3]

[Title of District Court and Cause.]

MINUTES OF THE COURT

JUNE 4, 1956

At: Los Angeles, Calif.

Present: Hon. Wm. C. Mathes, District Judge.
U. S. Att'y, by Ass't U. S. Att'y: John K. Duncan.

Counsel for Defendant: Angelo L. Baldwin (for Att'y David Marcus).
Defendant present (in custody).

Proceedings:

For arraignment and plea.

Defendant is arraigned.

It Is Ordered that cause is continued to June 11, 1956, 9:30 a.m., for plea.

JOHN A. CHILDRESS,
Clerk. [4]

[Title of District Court and Cause.]

MINUTES OF THE COURT

JUNE 11, 1956

Present: Hon. Wm. C. Mathes, District Judge.
U. S. Att'y, by Ass't U. S. Att'y: John K.
Duncan.
Counsel for Defendant: Angelo Baldwin.
Defendant present (in custody).

Proceedings:

For plea.

Defendant pleads not guilty to counts 1 and 2 of
Indictment.

Court Orders cause set for jury trial July 17, 1956, 10 a.m., on calendar of Judge Clarke.

JOHN A. CHILDRESS,
Clerk. [5]

TRANSCRIPT OF PROCEEDINGS
BEFORE THEODORE HOCKE, U. S. COMMIS-
SIONER, SOUTHERN DISTRICT OF CAL-
IFORNIA, AT LOS ANGELES

No. 19-199

UNITED STATES OF AMERICA

vs.

REFUGIO GONZALES LOZOYA

Complaint filed: May 18, 1956.

Charging violation: 26 USC 4742A.

Warrant issued: May 18, 1956.

Arraigned: May 18, 1956.

Wants prelim.

Mr. A. Gleason, Atty., appeared for Deft.

Bond \$7,500.00.

Filed: June 21, 1956. [6]

United States District Court for the
Southern District of California

Commissioner's Docket No. 19

Case No. 199

UNITED STATES OF AMERICA

vs.

REFUGIO GONZALES LOZOYA

COMPLAINT FOR VIOLATION OF U.S.C.
TITLE 26, SECTION 4742(a)

Before: Theodore Hocke, Commissioner, Los Angeles, California.

The undersigned complainant being duly sworn states:

That on or about May 17, 1956, at Los Angeles County, California, in the Southern District of California, Refugio Gonzales Lozoya did knowingly and unlawfully transfer 10 pounds of marihuana not in pursuance of any written order on a form issued for that purpose by the Secretary of the Treasury of the United States.

[Seal] /s/ JOSE RAMIREZ,
Narcotic Agent.

Sworn to before me, and subscribed in my presence, May 18, 1956.

/s/ THEODORE HOCKE,
United States Commissioner.

United States District Court for the Southern District of California, Central Division

Commissioner's Docket No. 19

Case No. 199

UNITED STATES OF AMERICA

vs.

REFUGIO GONZALES LOZOYA

WARRANT OF ARREST

To Any U. S. Marshal or Other Authorized Officer.

You are hereby commanded to arrest Refugio Gonzales Lozoya, and bring him forthwith before the nearest available United States Commissioner to answer to a complaint charging him with transfer 10 lbs. marihuana not in pursuance of written order on form prescribed by Secretary of Treasury in violation of U.S.C., Title 26, Section 4742a.

Date May 18, 1956.

/s/ THEODORE HOCKE,

United States Commissioner.

Return

Received 5/18, 1956. at Los Angeles, and executed by arrest of Defendant at Los Angeles County Jail on 5/18, 1956.

ROBERT W. WARE,
U. S. Marshal.

By /s/ C. W. ROBB,
Deputy.

Date 5/18, 1956.

Bond \$7,500. [8]

United States District Court for the Southern
District of California, Central Division

Commissioner's Docket No. 19

Case No. 199

UNITED STATES OF AMERICA

vs.

REFUGIO GONZALES LOZOYA

FINAL COMMITMENT OF
REFUGIO GONZALES LOZOYA

To: The United States Marshal of the Southern
District of California;

You are hereby commanded to take the custody of the above-named defendant and to commit him with a certified copy of this commitment to the custodian of a place of confinement within the Southern District of California approved by the Attorney General of the United States where the defendant shall be received and safely kept until discharged in due course of law. The above-named defendant was arrested upon the complaint of Jose Ramirez, Narcotics Agent, charging that on or about May 17, 1956, in the Southern District of California, the defendant did transfer 10 pounds of marihuana not in pursuance of written order, etc., in violation of U.S.C. Title 26, Section 4742a and he (having duly waived preliminary examination before me on May 18, 1956), has been directed to furnish bond in the sum of Seventy-five Hundred dollars (\$7500.) for

his appearance in the United States District Court for the Southern District of California at Los Angeles, in accordance with all orders and directions of the court relative to his appearance before the court, and he has failed to do so.

/s/ THEODORE HOCKE,
United States Commissioner.

Dated: May 18, 1956.

Return

Received this commitment and designated prisoner on 5/18, 1956, and on 5/18, 1956, committed him to L. A. County Jail, and left with the custodian at the same time a certified copy of this commitment.

ROBERT W. WARE,
U. S. Marshal.

By /s/ C. W. ROSS,
Deputy.

Dated: 5/18, 1956.

[Endorsed]: Filed June 21, 1956. [10]

[Title of District Court and Cause.]

WAIVER OF JURY

The above cause coming on regularly for trial, defendant being present with counsel,, Esq., and the defendant being desirous of having

the case tried before the Court without jury, now requests of the Court that the case be so tried and hereby consents that the Court shall sit without a jury and hear and determine the charges against the defendant without a jury.

Dated:

.....,

Defendant in Pro Per.

I have advised the defendant fully as to his rights and assure the Court that his request for a trial without a jury is understandingly made.

/s/ REFUGIO GONZALES
LOZOYA,

/s/ DAVID C. MARCUS,
Attorney for Defendant.

The United States Attorney consents that the request of the defendant be granted and that the trial proceed without a jury.

/s/ JOSEPH F. BENDER,
Assistant U. S. Attorney.

Approved:

/s/ THURMOND CLARKE,
United States District Judge.

[Endorsed]: Filed July 17, 1956. [11]

[Title of District Court and Cause.]

TRIAL MEMORANDUM

I.

Status of the Case

A. Defendant Refugio Gonzalez Lozoya is in custody in the County Jail.

B. Trial will be by jury.

C. It is estimated that the trial will require approximately two days.

D. The Government expects to call approximately seven or eight witnesses.

E. The indictment is in two counts as follows:

“Count One: On or about May 17, 1956, in Los Angeles County, California, within the Central Division of the Southern District of California, defendant, [12] Refugio Gonzalez Lozoya did knowingly and unlawfully transfer approximately nine and one-half pounds of marihuana to another without obtaining a written order on a form issued for that purpose by the Secretary of the Treasury of the United States.

“Count Two: On or about May 17, 1956, in Los Angeles County, California, within the Central Division of the Southern District of California, defendant, Refugio Gonzalez Lozoya, being a transferee required to pay the transfer tax imposed by Section 4741(a), Title 26, United States Code, did knowingly and unlawfully acquire and obtain ap-

proximately nine and one-half pounds of marihuana without having paid such tax.”

II.

The Statutes Under Which the Defendant Is Being Prosecuted

United States Code, Title 26, Section 4742(a), provides in pertinent part as follows:

“It shall be unlawful for any person, whether or not required to pay a special tax and register under Sections 4751 to 4753, inclusive, to transfer marihuana, except in pursuance of a written order of the person to whom such marihuana is transferred, on a form to be issued in blank for that purpose by the Secretary or his delegate.”

United States Code, Title 26, Section 4744(a), provides in pertinent part as follows: [13]

“It shall be unlawful for any person who is a transferee required to pay the transfer tax imposed by Section 4741(a) to acquire or otherwise obtain any marihuana without having paid such tax; and proof that any person shall have had in his possession any marihuana and shall have failed, after reasonable notice and demand by the Secretary or his delegate, to produce the order form required by Section 4742 to be retained by him shall be presumptive evidence of guilt under this section and of liability for the tax imposed by Section 4741(a).”

III.

Summary of Evidence to Be
Offered by the Government

The Government anticipates the evidence will substantially prove that Federal Narcotics Agent Jose Ramirez met defendant, Refugio Gonzalez Lozoya, on or about May 17, 1956, at about 7:30 o'clock p.m. in the parking lot of the Beverly Ranch Market, in the vicinity of Beverly and Popular Streets in Montebello, California. Said Agent and defendant discussed the price of defendant's marihuana for the instant and future transactions. Defendant stated his marihuana is of very good quality. Defendant opened the trunk of the automobile he had driven into said parking lot, removed a burlap sack containing approximately nine and one-half pounds of marihuana and placed this sack into the trunk of the Government automobile of Agent Ramirez.

Defendant Lozoya was observed by other Federal Narcotics Agents when defendant did the aforesaid acts. Said Agents then placed defendant under [14] arrest.

On or about May 24, 1956, demand was made on defendant to produce a written form issued by the Secretary of the Treasury authorizing transfer of said marihuana to Agent Ramirez. Defendant indicated that he had not obtained and did not have a written form for the transfer of said marihuana.

7

IV.

Pertinent Case Law

Transfer of Marihuana [Sec. 4742(a), Title 26,
United States Code]

In the absence of the production of evidence by the defendant that he has complied with the provisions of Section 4742 relating to order forms, he shall be presumed not to have complied with such provisions. The burden is upon the defendant to prove that the marihuana found in his possession was transferred to him pursuant to a written order blank required by Section 4742.

United States v. Williams

(2nd Cir., 1947), 161 F. 2d 837 (relating to
a former marihuana section 2591).

Unlawful Possession of Marihuana [Sec. 4744(a),
Title 26, United States Code]

The essential elements of the offense specified in former Section 2593(a) [now Section 4744(a)] are: (1) That the defendant is a transferee, (2) required to pay the transfer tax. (3) That he obtained marihuana (4) without having paid the tax.

Symons v. United States

(9th Cir., 1950), 178 F. 2d 615, 621.

The gist of the offense specified in former Section 2593(a) is nonpayment by a transferee of marihuana of the required tax, and it is not an element of that offense that the transferee has failed after reasonable notice and demand to produce the re-

quired [15] order form. The latter part of the section relates to a means of proof and not to a definition of crime.

Cratty v. United States

(D.C. Cir., 1947), 163 F. 2d 844, 849.

Informants

The identity of an informer is confidential. It has been settled for many years that a government official cannot be compelled to disclose the identity of an informer.

Scher v. United States,

305 U. S. 251, at page 254.

This rule has been followed by the Court of Appeals for the Ninth Circuit in the case of:

McInes v. United States,

62 F. 2d 180, where it was said:

“* * * to inform is a statutory duty and sound public policy forbids exposing informers to possible, even probable, evil consequences.”

The Government does not anticipate that any unusual questions of law will arise in this case.

V.

Counsel for defendant is herewith informed that the defendant may, if so advised, serve and file a similar “Trial Memorandum” at or prior to commencement of the trial.

Respectfully submitted,

LAUGHLIN E. WATERS,
United States Attorney;

LOUIS LEE ABBOTT,
Assistant U. S. Attorney,
Chief, Criminal Division;

/s/ JOSEPH F. BENDER,
Assistant U. S. Attorney, Attorneys for Plaintiff,
United States of America.

Affidavit of Service by Mail attached.

[Endorsed]: Filed July 12, 1956. [16]

[Title of District Court and Cause.]

MINUTES OF THE COURT, JULY 17, 1956

Present: Hon. Thurmond Clarke, District Judge.

U. S. Att'y, by Ass't U. S. Att'y Joseph F.
Bender.

Counsel for defendant: David Marcus.

Defendant present (in custody) (on bond) (on
O/R).

10:30 a.m. Court convenes with defendant and
counsel present.

Proceedings: For Jury Trial:

Jury Waiver filed, signed by defendant, both
counsel and approved by the court.

Both sides move to exclude all witnesses from courtroom until called and court grants motion and orders witnesses excluded until called.

Plaintiff's Exhibit 2 marked for identification. Plaintiff witness Jose Ramirez is called, sworn and testifies.

11:07 a.m. Court recesses; 11:15 a.m. Court reconvenes with both counsel and defendant present. Plaintiff witness Jose Ramirez resumes testimony.

12:00 noon Court recesses.

2:00 p.m. Court reconvenes with both counsel and defendant present. Plaintiff witness Jose Ramirez, heretofore sworn, resumes testimony.

3:00 p.m. Court recesses and at 3:20 p.m., court reconvenes with all parties present. Plaintiff witness Jose Ramirez resumes testimony. Plaintiff's Exhibit No. 1 marked for identification.

4:00 p.m. Court recesses until 9:45 a.m., July 18, 1956.

JOHN A. CHILDRESS,
Clerk. [18]

[Title of District Court and Cause.]

MINUTES OF THE COURT, JULY 18, 1956

Present: Hon. Thurmond Clarke, District Judge.

U. S. Att'y, by Ass't U. S. Att'y Joseph F. Bender.

Counsel for defendant: David Marcus.

Defendant present (in custody). ✓

Proceedings: For further Court trial.

9:45 a.m., court convenes; defendant and counsel present; court orders trial proceed.

Jose Ramirez, heretofore sworn, resumes the stand on behalf of Gov't.

Government's Exhibits 1-A and 1-B, heretofore marked, are now offered.

Government's Exhibit 2, heretofore marked, now admitted and signed by the Court.

Government's Exhibit 1 marked for identification.

10:50 a.m., recess and Witness Ramirez is instructed not to discuss case with any other witness.

11:20 a.m., Court reconvenes; all present as before; Court orders trial proceed.

Myer Goodman is called, sworn and testifies behalf of Gov't.

Gov'ts Exhibits 1-A, 1-B and 1 are again offered in evidence.

12:15 p.m., recess to 2:00 p.m.

2:10 p.m., Court reconvenes; all present as before; Court orders trial proceed.

Meyer Goodman, heretofore sworn, is recalled.

3:00 p.m., recess.

3:20 p.m., Court reconvenes; all present as before; Court orders trial proceed.

Meyer Goodman resumes the stand on behalf of Gov't.

Gov't again moves to have admitted into evidence Gov't Exhibits 1-A, 1-B and 1 and Court reserves ruling until 10:00 a.m., 7/19/56, after the reporter reads certain testimony of Witness Jose Ramirez,

Narcotic Agent, to both counsel after Court adjourns.

4:00 p.m., Court adjourns until 10:00 a.m., July 19, 1956.

JOHN A. CHILDRESS,
Clerk. [19]

[Title of District Court and Cause.]

MINUTES OF THE COURT, JULY 19, 1956

Present: Hon. Thurmond Clarke, District Judge.

U. S. Att'y, by Ass't U. S. Att'y Joseph F. Bender.

Counsel for defendant: David Marcus.

Defendant present (in custody).

Proceedings: For further trial.

At 10:10 a.m. court convenes herein. Defendant and counsel for both sides are present. Court orders trial proceed.

Meyer I. Goodman, heretofore sworn, is recalled and testifies in behalf of Gov't. At 11:00 a.m. court recesses.

At 11:20 a.m. court reconvenes herein, and defendant and counsel for both sides being present, Court orders trial proceed.

Meyer I. Goodman resumes the stand and testifies further.

Gov't Exs. 1, 1-A and 1-B, heretofore marked for ident., and now offered and admitted in evidence.

Michael Gullon is called, sworn, and testifies in behalf of Gov't.

At 12:10 p.m. court recesses to 2:00 p.m. At 2:00 p.m. court reconvenes herein, and all being present as before, including defendant and counsel for both sides, Court orders trial proceed.

Michael Gullon resumes the stand and testifies further.

Bill H. Freeman is called, sworn, and testifies for Gov't.

At 3:10 p.m. court recesses.

At 3:20 p.m. court reconvenes herein, and defendant and counsel for both sides being present, Court orders trial proceed.

Gov't rests.

At 3:22 p.m. Refugio Gonzales Lozoya is called, sworn, and testifies in his own behalf.

At 4:00 p.m. It Is Ordered that cause is continued to 10:00 a.m., July 20, 1956, for further trial.

JOHN A. CHILDRESS,
Clerk. [20]

[Title of District Court and Cause.]

MINUTES OF THE COURT, JULY 20, 1956

Present: Hon. Thurmond Clarke, District Judge.

U. S. Att'y, by Ass't U. S. Att'y Joseph F. Bender.

Counsel for defendant: David Marcus.

Defendant present (in custody).

Proceedings: For further trial.

At 10:00 a.m. court convenes herein. Defendant and counsel for both sides are present. Court orders trial proceed.

Refugio Gonzalez Lozoya, heretofore sworn, resumes the stand.

Mary Catherine Macias is called, sworn, and testifies in behalf of defendant.

Defendant rests.

Robert E. Miller is called, sworn, and testifies on rebuttal in behalf of Gov't. At 10:40 a.m. Gov't rests.

Attorney Bender makes final statement.

Court Rules that defendant is not guilty on both counts of Indictment and Orders defendant released from custody.

It Is Ordered that Gov't Ex. 1 (narcotics) be placed in the vault in Room 329.

JOHN A. CHILDRESS,
Clerk. [21]

United States District Court
for the
Southern District of California
Office of the Clerk
231 U. S. Post Office and Court House
Los Angeles 12, California

July 30, 1956.

Re: USA v. Refugio Gonzalez Lozoya, No.
25,033, Crim., Central Division.

Received from the Clerk following exhibits in
above case this July 30, 1956:

1-a (outer wrappings of box).

1-b (cardboard box).

1 (burlap sack, paper sacks and contents approxi-
mately 9½ pounds marihuana).

U. S. ATTORNEY,

By /s/ JOSEPH F. BENDER,

Assistant U. S. Attorney.

[Endorsed]: Filed July 30, 1956. [22]

United States District Court, Southern District of
California, Central Division

No. 25033—CD—Criminal

UNITED STATES OF AMERICA,

Plaintiff,

vs.

REFUGIO GONZALEZ LOZOYA,

Defendant.

ORDER TO SHOW CAUSE

To Jose Ramirez, Meyer Goodman, Michael Gullon,
Bill H. Freeman and Robert E. Miller:

You and Each of You Are Hereby Ordered and Directed to be and appear before the Honorable Thurmond Clarke, Judge of the United States District Court, Southern District of California, Central Division, at the Court Room of said Court in the Post Office and Federal Building, Los Angeles, California, on Thursday, the 10th day of January, 1957, at the hour of 9:30 o'clock a.m., to show cause why the petition of the defendant, Refugio Gonzalez Lozoya, should not be granted and why you and each of you, and any other Federal Officers who contemplate testifying, should not be enjoined and restrained from testifying against the defendant, Refugio Gonzalez Lozoya, in that certain action in the Municipal Court of the Los Angeles Judicial District, County of Los Angeles, State of [23] California, entitled "People of the State of California, Plaintiff, vs. Refugio Gonzalez Lozoya, Defendant,

No. 133,389," on January 11, 1957, in Division 4 of said Municipal Court.

Pending the determination of this Order to Show Cause, you and each of you, and any other Federal officers who contemplate testifying in said Municipal Court action, are hereby enjoined and restrained from testifying therein, or from using the marihuana as evidence in the said proceedings, or from removing said marihuana from the jurisdiction of this Court.

Dated this 4th day of January, 1957.

/s/ THURMOND CLARKE,
United States District Judge.

Good cause being shown, time for service is hereby shortened two days prior to January 10th, 1957.

/s/ THURMOND CLARKE,
United States District Judge.

[Endorsed]: Filed January 4, 1957. [24]

[Title of District Court and Cause.]

PETITION OF
REFUGIO GONZALEZ LOZOYA

To the Honorable United States District Court for
the Southern District of California, Central Division:

The petition of Refugio Gonzalez Lozoya respectfully recites:

I.

That by an indictment returned by the Federal Grand Jury of the Southern District of California, Central Division, petitioner was charged in the above-entitled and numbered case in Count One:

“On or about May 17, 1956, in Los Angeles County, California, within the Central Division of the Southern District of California, * * * knowingly and unlawfully transfer approximately nine and one-half pounds of marihuana to another without obtaining a written order on a form issued for that purpose by the Secretary of the Treasury of the United [25] States.”

and in Count Two of said indictment:

“On or about May 17, 1956, in Los Angeles County, California, within the Central Division of the Southern District of California, * * * did knowingly and unlawfully acquire and obtain approximately nine and one-half pounds of marihuana without having paid * * *”

the transfer tax imposed by Section 4741(a), Title 26, United States Code; all as contained in said indictment on file in the above-entitled proceedings. That bail was fixed by said indictment in the sum of \$7,500.00 by the District Court of the United States.

II.

That petitioner was taken into custody by virtue of the warrant issued pursuant to said indictment,

and thereafter, and on the 11th day of June, 1956, petitioner appeared before the Honorable Thurmond Clarke, District Judge of the United States for the Southern District of California, Central Division, and did enter a plea of not guilty to each of said counts.

III.

That said matter was thereupon duly set for trial and the trial of petitioner on his plea of not guilty to the charges contained in said indictment was had before the Honorable Thurmond Clarke commencing on July 17, 1956, and continuing thereafter on July 18, 19 and 20, 1956.

IV.

That during the trial of said proceedings the Court received in evidence Exhibit 1, being the marihuana as charged in said indictment.

V.

That during all times herein mentioned, Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller were and now are employees of the Federal Bureau of Narcotics, who appeared and testified on behalf of the Government in the proceedings before said United States District Court against petitioner concerning [26] the purported transactions involving said marihuana as alleged in said indictment.

VI.

That on the 20th day of July, 1956, upon the conclusion of the trial proceedings before said

Court, petitioner was found not guilty on each of the counts of said indictment as aforesaid and ordered released, and was released, from custody.

VII.

That said marihuana named in said indictment and received in evidence in said proceedings as Exhibit 1 was by the Clerk of said Court, as appears from the criminal docket of said Court, deposited in the vault of said Court in Room 329 of the Federal Building, Los Angeles, California, within the jurisdiction of said Judge and said Court as aforesaid.

VIII.

That said marihuana was at all times herein contrabrand and that the crime charged against petitioner and the contrabrand so deposited with said Court was subject to the provisions of Section 2463 of Title 28, U.S.C., which in part provides as follows:

“All property taken or detained under any Revenue law of the United States shall not be repleviable, but shall be deemed to be in the custody of the law and subject only to the orders and decrees of the courts of the United States having jurisdiction thereof.”

IX.

That subsequent to petitioner's acquittal of said charge in said Federal Court, the said Jose Ramirez, an employee of the said Federal Bureau of Narcotics of the Government of the United States as

aforesaid, did on the 10th day of August, 1956, appear at the office of the District Attorney of the County of Los Angeles, State of California, as the complainant against petitioner, the said Jose Ramirez having been one of the principal witnesses who appeared [27] at the trial of petitioner before the United States District Court and the Honorable Thurmond Clarke, and testified against petitioner, and did cause and procure the issuance of a complaint, No. 133,389, by signing, subscribing and swearing to said complaint and the facts therein alleged before the Municipal Court of the Los Angeles Judicial District, County of Los Angeles, State of California, in which the petitioner herein was charged with the illegal possession of contraband marihuana on the 17th day of May, 1956, at and in the County of Los Angeles, State of California, in violation of Section 11500 of the Health and Safety Code of the State of California, the said contraband marihuana so charged being the identical contraband marihuana upon which petitioner was indicted and charged in the Federal Court and received in evidence at the trial of petitioner before said Court.

X.

That a warrant was issued pursuant to said complaint in said Municipal Court and bail on said warrant was set in the sum of \$10,000.00. That petitioner was thereafter apprehended and is now confined and restrained of his liberty in the County

Jail of the County of Los Angeles by virtue of said complaint and warrant.

XI.

That the preliminary hearing on said complaint is now set for January 11, 1957, in Division 4 of the Municipal Court of the Los Angeles Judicial District.

XII.

That without an order of the United States District Court and in violation of Section 2463 of Title 28, U.S.C., as aforesaid, said contraband marihuana was removed from the custody of said Court on the 30th day of July, 1956, and since said time has not been in the possession of said United States District Court; that said contraband marihuana was delivered to the possession of said Jose Ramirez, who did, on the 11th day of December, 1956, appear in said Municipal [28] Court and did at said time have in his possession the said Exhibit as aforesaid without an order or decree of said Court authorizing said Jose Ramirez or any other person to withdraw said Exhibit from the possession of said Federal Court as aforesaid.

XIII.

That said Jose Ramirez and Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller, as aforesaid, being at all times herein mentioned Federal narcotic officers, intend to, and since the issuance of said complaint in said Municipal Court, as aforesaid, have intended to testify against

petitioner in said proceedings pending before the Municipal Court of the Los Angeles Judicial District, as aforesaid, and intend to use, and will use, said contraband marihuana in evidence against petitioner herein.

XIV.

Petitioner alleges that the acts, conduct and omissions constituting his purported possession and transfer of said contraband marihuana to another on May 17, 1956, as alleged in Count One of the indictment in the Federal Court, and his knowingly and unlawfully acquiring and obtaining approximately nine and one-half pounds of marihuana as alleged in Count Two of said indictment, are the same identical transactions and founded upon the alleged acts and omissions as alleged in the Municipal Court complaint as aforesaid, in which petitioner is charged with having "in his possession flowering tops and leaves of Indian Hemp (*cannibis sativa*) in violation of Section 11500, Health and Safety Code of the State of California," and that the said acts and omissions of petitioner as aforesaid in the Federal indictment and in the complaint issued by the State of California are purportedly founded upon the same identical acts and conduct of the defendant and necessarily included within the federal charge as aforesaid.

XV.

That the said State case as aforesaid against petitioner herein [29] is founded upon and will be made by testimony of the said Federal narcotic officers,

Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller, as aforesaid, who are prepared to and will testify in said State Court proceedings as aforesaid, and intend to and will use and offer in evidence the same identical contraband marihuana used and received in the Federal Court as evidence against petitioner.

XVI.

That the actions of the Federal narcotic officers as aforesaid in causing petitioner's arrest under said State charge by reason whereof petitioner is now confined and restrained of his liberty as aforesaid, have caused petitioner herein to be deprived of due process of law in violation of the Fifth and Fourteenth Amendments of the Constitution of the United States.

XVII.

That the said Federal officers and each of them, as aforesaid, and the District Attorney of the County of Los Angeles and his deputies, well knew at the time of the issuance of said complaint as aforesaid that petitioner had been acquitted of the charges in the Federal Court, and that the case against petitioner would have to be made upon the testimony of said Jose Ramirez and the other Federal narcotic officers.

XVIII.

That the said officers as aforesaid have at all times since the finding of not guilty by the Federal Court of your petitioner as aforesaid, had knowl-

edge of the judgment of said Court that petitioner was not guilty of said Federal charges; however, in disregard of said acquittal of petitioner and in order to vex, harass and annoy him, and in violation of his constitutional rights under the Fifth and Fourteenth Amendments of the Constitution of the United States, the said officers, as aforesaid, and in particular the said Jose Ramirez, did unlawfully and illegally, in violation of [30] petitioner's constitutional rights, sign, swear to and cause the issuance of the aforementioned complaint, and by reason thereof did cause the arrest of petitioner and did cause him to be twice placed in jeopardy for the same identical and necessarily included offense in the Federal and State Courts as aforesaid.

XIX.

That the said contraband marihuana so received by said Federal officers and in their possession and control, as aforesaid, which contraband marihuana is intended to be used in the said prosecution in the State Court, is in contravention of the Fifth and Fourteenth Amendments of the Constitution of the United States and the statutes so made and provided.

XX.

That petitioner has no speedy or adequate remedy at law against the actions of said Federal officers, as aforesaid, and unless said officers are restrained and enjoined from testifying in said State Court concerning said matters and the use of said contraband marihuana, as aforesaid, said officers intend

to and will proceed to do so against petitioner herein, all in violation of his constitutional rights as aforesaid.

XXI.

That it is immediately necessary and appropriate, for which the law affords no speedy and adequate remedy, that this Court make such order in order that petitioner's rights as guaranteed by the Fifth and Fourteenth Amendments of the Constitution of the United States be preserved to him, which will be denied to him by the officers of the Federal Bureau of Narcotics, employees of the Government of the United States.

XXII.

That by reason of the foregoing petitioner is now and since the date of his arrest has been illegally and unlawfully detained and deprived of his liberty by reason and virtue of the acts and conduct [31] of the Federal narcotic officers as aforesaid.

Wherefore, petitioner prays:

(1) That said Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller, and any other Federal officers who contemplate testifying, be enjoined and restrained by appropriate order of this Court from testifying in proceedings in the State Court entitled, "In the Municipal Court of Los Angeles Judicial District, County of Los Angeles, State of California, the People of the State of California, Plaintiff, vs. Refugio Gonzalez Lozoya, Defendant, No. 133,389,"

or any other proceedings founded upon the said charge involving said contraband marihuana as alleged herein.

(2) That said Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller be by appropriate order of this Court directed to acquire, or reacquire, and take possession of and deliver to the Clerk of the United States District Court for the Southern District of California, Central Division, the contraband marihuana named in the indictment and complaint herein mentioned, being approximately nine and one-half pounds of marihuana, and that said contraband marihuana be ordered destroyed by order of this Court in conformity with the provisions of Section 2463 of Title 28, U.S.C., and for such other effective orders as may be appropriate under the circumstances and allegations of this petition, in order that petitioner be afforded due process and the equal protection of the laws, and that he be not deprived of his liberty without due process of law.

Dated this 2nd day of January, 1957.

REFUGIO GONZALEZ
LOZOYA,
Petitioner;

By /s/ DAVID C. MARCUS,
Attorney for Petitioner.

Duly verified.

[Endorsed]: Filed January 4, 1957. [32]

[Title of District Court and Cause.]

BRIEF BY RESPONDENTS IN OPPOSITION
TO ORDER TO SHOW CAUSE

Comes Now respondents Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller, by their counsel, Laughlin E. Waters, United States Attorney, by Joseph F. Bender, Assistant United States Attorney, and file their brief and points and authorities in opposition to the order to show cause why they should not be enjoined and restrained, as requested by Refugio Gonzalez Lozoya in his petition, dated January 2, 1957.

Respondents should not be enjoined for the following reasons:

(1) No constitutional right of Refugio Gonzalez Lozoya under the Fifth, Fourteenth or any Amendment of the Constitution of the United States has or will be violated by prosecution of petitioner in the state court and testimony therein by [52] respondents.

(2) The marihuana involved was not obtained by unlawful search and seizure from petitioner Refugio Gonzalez Lozoya.

(3) Prosecution and acquittal of petitioner Refugio Gonzalez Lozoya in the federal court for unlawful acquisition and transfer of marihuana does not constitute former jeopardy, to bar prosecution

of petitioner in the state court for possession of marihuana.

Dated: January 9, 1957.

Respectfully submitted,

LAUGHLIN E. WATERS,
United States Attorney;

LOUIS LEE ABBOTT,
Assistant U. S. Attorney,
Chief, Criminal Division;

/s/ JOSEPH F. BENDER,
Assistant U. S. Attorney,
Attorneys for Respondents.

Respondents' Points and Authorities
in Opposition to Order to Show Cause

Respondents make the following points and cite the following authorities in opposition to the petition of Refugio Gonzalez Lozoya to enjoin respondents:

I.

Respondents ask but one question of petitioner, viz.:

What rights of Refugio Gonzalez Lozoya would be violated if the court does not enjoin respondents? The answer is, No rights of petitioner would be violated because:

(a) The Fifth Amendment to the Constitution of the United States provides in part, "No person

shall be deprived of * * * property without due process of law * * *'' Petitioner has never claimed ownership of the marihuana. He was lawfully arrested on a valid charge by the State of California, has had an adequate opportunity to retain and has retained counsel to prepare a defense and have a fair hearing before a court having jurisdiction, as required by the Fifth Amendment.

See: *Powell v. Alabama*, 287 U. S. 45.

(b) The Fourteenth Amendment requires due process and equal protection be accorded petitioner by the State of California. The Fourteenth Amendment requires the state to prosecute petitioner properly. No question of impropriety of the state proceedings is before the federal court. (The question of former jeopardy will be discussed later.)

(c) The Fourth Amendment is placed in issue by petitioner Lozoya who cites the *Rea v. United States* case as authority to enjoin respondents. The *Rea* case holds that where a federal narcotics agent unlawfully obtains evidence from defendant by unlawful search and seizure and "plans to use his illegal search [54] and seizure as the basis of testimony in the state court," the federal agent will be enjoined from testifying in the state trial. The rationale of the *Rea* case is simply that a federal agent who has violated the federal Rules governing searches and seizures cannot flout the rules "and use the fruits of his unlawful act either in federal or state proceedings."

If petitioner seriously contends that the Rea case is authority to now enjoin federal narcotics agents from testifying in the state court, why did he not assert the Rea case as authority to enjoin the same agents from testifying against him in the initial federal proceedings. In the Rea case the federal district court granted the motion of defendant to suppress the evidence before trial in the federal court. The evidence, the marihuana, had been illegally obtained from defendant by the federal narcotics agent by what constituted an unlawful search and seizure of the marihuana from defendant. In the instant Lozoya case there was no unlawful search or seizure by the agents. At no time has Lozoya claimed and proved, as he must, that the marihuana is his and that it was taken from his possession by unlawful search and seizure. Indeed, the antithesis was asserted by Lozoya during the federal trial; he contended it was not his marihuana.

The respondents, in the instant case, obtained the marihuana lawfully in the performance of their federal duties. They violated no constitutional right of petitioner to be secure against unlawful searches and seizures and should be permitted to testify as witnesses in the state court in the pending criminal proceeding in that forum against petitioner Lozoya for possession of the marihuana.

In the absence of allegation and proof that the marihuana involved was obtained by respondents unlawfully, the Rea case, if applicable, is authority

for denial of the petition to enjoin [55] respondents.

Rea v. United States,
350 U. S. 214, especially pages 217 and the
top of page 218.

II.

Petitioner is not placed in double jeopardy by his trial and acquittal in the federal court and subsequent state prosecution. In the federal prosecution, petitioner was tried on one count for unlawful acquisition of marihuana without having paid the federal tax; in the other count, he was charged with unlawful transfer of marihuana without payment of said tax. On the other hand, in the state proceedings, defendant Lozoya is charged with possession of marihuana.

(a) The test of double jeopardy is whether defendant has been put in jeopardy for the same offense, not whether he has been tried for the same act.

Poffenbarger v. United States
(C.C.A. Iowa), 20 F. 2d 42, 45.

(b) The constitutional guaranty against "double jeopardy" is against jeopardy for the same offense and not against repetition of evidence in trial for different offenses or against incidental proving of the same offense, if such offense is an offense which has not theretofore been charged and prosecuted.

United States v. Brimsdon
(D.C. Mo.), 23 F. Supp. 510, 512.

(c) Where the same act is an offense against both state and federal governments, its prosecution and

punishment by the latter after prosecution and punishment by the former, is not double jeopardy.

United States v. Lanza,

260 U. S. 377, and in particular pages 383,
384 and 385. [56]

The Lanza case, decided by the Supreme Court of the United States, involved a prior conviction in the state court and subsequent trial and conviction in the federal court. Although two punishments were imposed, one by each sovereign, the Supreme Court affirmed the conviction and found no double jeopardy. A fortiori, the moral equities in favor of petitioner Lozoya are less compelling as he was acquitted by the first forum, and could suffer imposition of but one punishment if convicted in the state proceedings.

The Lanza case involved a second prosecution for the identical offense involved in the state prosecution, i.e., unlawfully transporting and selling intoxicating liquors. In the Lozoya case, the offenses are not only crimes against separate sovereigns but are different crimes, i.e., acquisition and transfer, in the federal proceedings and mere possession in the state proceedings. *Delacerda v. United States*, 223 F. 2d 831.

(d) The jurisdiction of the federal courts over a prosecution against one charged with the unlawful possession of smoking opium is not exclusive.

United States v. Ah Hung,

243 Fed. 762.

III.

(a) Congress has conferred upon the Secretary of the Treasury the authority to destroy or deliver marihuana confiscated by and forfeited to the United States, to any department or agency of the government, including the Federal Narcotics Bureau.

26 U.S.C., 2598(d).

(b) Delivery of the marihuana from the Secretary of the Commissioner of Narcotics is provided in T.D. 28, order of the Secretary of the Treasury relating to the enforcement of the marihuana tax act of 1937. [57]

(c) Distinguish 28 U.S.C., 2463, as discussed in the Rea case. This section is entitled, "Property Taken Under Revenue Law Not Repleviable." All that Section 2463 refers to is the question of replevy (reacquisition) of the marihuana by the true owner who claims same. In the Rea case, the court discussed Federal Criminal Rule 41(e) which permits a District Court to suppress evidence obtained by unlawful searches and seizures.

The Rea case extended the rule and held that when "a federal agent has violated the federal rules governing searches and seizures * * *" the federal court may enjoin the federal officer from using "the fruits of his unlawful act" as "the basis of testimony in the state court." In the absence of acquisition of the marihuana by federal agents by unlawful search and seizure, the provisions of 26 U.S.C. 2598(d) apply and give the Secretary alone the power to destroy or deliver marihuana to the Nar-

cotics Bureau. The disposition of the marihuana thereafter is subject to the orders of the Secretary of the Treasury or his delegate as stated in (a) and (b), *supra*.

IV.

The marihuana involved was withdrawn from evidence by Assistant United States Attorney Joseph F. Bender in compliance with local Rule 20(a), in the same manner as all evidence is normally withdrawn from the custody of the Federal Clerk subsequent to final disposition of the case. By reason of the acquittal of petitioner, no further proceedings could be had against him on the federal indictment and removal of the exhibits (evidence) offered by the government was completely proper.

“* * * All * * * exhibits, * * * filed in any cause, shall, * * * be returned to the party or person to whom they belong, * * *”

Rule 20(a), Local Rules of the United States District Court [58] for the Southern District of California (first paragraph thereof).

Respectfully submitted,

LAUGHLIN E. WATERS,

United States Attorney;

LOUIS LEE ABBOTT,

Assistant U. S. Attorney,

Chief, Criminal Division;

/s/ JOSEPH F. BENDER,

Assistant U. S. Attorney,

Attorneys for Respondents.

[Endorsed]: Filed January 9, 1957. [59]

United States District Court, Southern District of
California, Central Division

No. 25033—CD—Criminal

UNITED STATES OF AMERICA,
Plaintiff,

vs.

REFUGIO GONZALES LOZOYA,
Defendant.

ORDER RESTRAINING FEDERAL OFFICERS
FROM TESTIFYING IN STATE CRIM-
INAL PROCEEDINGS

Application for an injunction having been duly made, and the Court finding that defendant Refugio Gonzales Lozoya, from the time of his first detection, and including his arrest, and interrogation and search and seizure of the subject of the offense consisting of nine and one-half pounds of marihuana, incarceration and interrogation, was in fact deprived of due process of law and of the American tradition of fair play that included beatings and torture by agents and employees of the United States Government, to wit: Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller; and good cause appearing,

It Is Hereby Ordered that said Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller are hereby permanently enjoined from testifying concerning the subject of said detection, apprehension, arrest, interrogation

and the search and seizure of said nine and one-half pounds of marihuana, and said parties, together with their agents, associates and any parties having the said nine and one-half pounds of marihuana are ordered to forthwith return and deposit the same with the Clerk of this Court Room, and all persons are restrained from ordering and [60] compelling the parties enjoined herein, from testifying in any proceeding.

Dated: This 10th day of January, 1957.

/s/ THURMOND CLARKE,

United States District Judge.

[Endorsed]: Filed January 10, 1957. [61]

[Title of District Court and Cause.]

MINUTES OF THE COURT, JAN. 10, 1957

Present: Hon. Thurmond Clarke, District Judge.

U. S. Att'y, by Ass't U. S. Att'y Joseph F. Bender.

Counsel for defendant: David C. Marcus.

Proceedings:

Hearing Petition of Deft. Refugio Gonzalez Lozoya, OSC, re: Restraining Federal Narcotic Officers From Testifying and Using Exhibit of Narcotic Drug in Action No. 133,389—People of State of Calif. vs. Lozoya on Jan. 11, 1957, in Division 4 of said Municipal Court.

Attorney Marcus makes statement in support of petition.

Attorney Bender makes statement in opposition.

The Court orders following order filed, a copy of which has been handed to each counsel, that Federal Narcotic Officers are hereby permanently enjoined from testifying concerning the subject of said detection, apprehension, arrest, interrogation, and the search and seizure of said nine and one-half pounds of marihuana, and said parties, together with their agents, associates, and any parties having the said nine and one-half pounds of marihuana are ordered to forthwith return and deposit the same with the Clerk of this Courtroom, and all persons are restrained from ordering and compelling the parties enjoined herein from testifying in any proceeding.

Court advises will file an opinion in the matter at a later date.

JOHN A. CHILDRESS,

Clerk;

By /s/ E. J. FISHER,

Deputy Clerk. [62]

[Title of District Court and Cause.]

RECEIPT FOR MONEY, EVIDENCE,
OR OTHER PROPERTY

District No. 14.

Case No. Cal.—1105—M.

Date: January 11, 1957.

Case No. 25033—Crim. U. S. A. vs. Refugio Gonzalez Lozoya.

To: Howard W. Chappell, Narcotic Agent.

Receipt is hereby acknowledged of the following-described money, evidence, or other property, which was given into my custody by the above-named narcotic officer.

Number of Items: 1.

Description of Items: Exhibit No. 1 consisting of ten paper sacks containing marihuana enclosed in burlap bag weighing approximately 9½ pounds, turned over to Clerk of Court.

Under "Description of items" show whether box, can, bottle, etc.; under "Quantity of drug or amount of money" the number of grains, ounces, or amount of money as shown on outside of package or envelope.

Custodians will not receive packages of evidence, money, or drugs not properly sealed, initialed, and dated.

JOHN A. CHILDRESS,

Clerk;

By /s/ E. J. FISHER,

Deputy Clerk.

[Endorsed]: Filed January 11, 1957. [63]

[Title of District Court and Cause.]

RETURN ON SERVICE OF WRIT

United States of America,
Southern District of California—ss.

I hereby certify and return that I served the annexed Order to Show Cause on the therein-named Jose Ramirez by handing to and leaving a true and correct copy thereof with him, personally, at Room 1755, Federal Building, at Los Angeles, Calif., in the said District at 12:45 p.m., on the 7th day of January, 1957.

/s/ R. W. WARE,

United States Marshal;

By /s/ JOHN E. SEARS,

Deputy.

Marshal's fees: \$2.00.

Mileage: \$2.00. [47]

[Title of District Court and Cause.]

RETURN ON SERVICE OF WRIT

United States of America,
Southern District of California—ss.

I hereby certify and return that I served the annexed Order to Show Cause on the therein-named Meyer Goodman by handing to and leaving a true and correct copy thereof with him, personally at Room 1755, Federal Bldg., at Los Angeles, Calif.,

in the said District at 12:45 p.m., on the 7th day of January, 1957.

/s/ R. W. WARE,
United States Marshal;

By /s/ JOHN E. SEARS,
Deputy.

Marshal's fees: \$2.00.

Mileage: \$2.00. [48]

[Title of District Court and Cause.]

RETURN ON NON-SERVICE OF WRIT

United States of America,
Southern District of California—ss.

I hereby certify and return that I received the annexed Order to Show Cause on 1-8, 1957, and returned same not served as to Michael Gullon, Fed. Bldg., on 1-11, 1957.

Reason: Out of town. Time's expired.

ROBERT W. WARE,
United States Marshal;

By /s/ JOHN E. SEARS,
Deputy. [49]

[Title of District Court and Cause.]

RETURN ON SERVICE OF WRIT

United States of America,
Southern District of California—ss.

I hereby certify and return that I served the annexed Order to Show Cause on the therein-named Bill H. Freeman by handing to and leaving a true and correct copy thereof with him, personally at Room 1755, Fed. Bldg., at Los Angeles, Calif., in the said District at 4:30 p.m., on the 7th day of January, 1957.

/s/ R. W. WARE,

United States Marshal;

By /s/ JOHN E. SEARS,
Deputy.

Marshal's fees: \$2.00.

Mileage: \$2.00. [50]

[Title of District Court and Cause.]

RETURN ON NON-SERVICE OF WRIT

United States of America,
Southern District of California—ss.

I hereby certify and return that I received the annexed Order to Show Cause on 1-8, 1957, and returned same not served as to Robert E. Miller on 1-11, 1957.

Reason: Unable to serve; out of town; time expired.

ROBERT W. WARE,
United States Marshal;

By /s/ JOHN E. SEARS,
Deputy. [51]

[Title of District Court and Cause.]

NOTICE OF APPEAL TO COURT
OF APPEALS UNDER RULE 73(b)

Notice Is Hereby Given that Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller, respondents, in the proceedings to enjoin which was filed in the captioned action by petitioner Refugio Gonzalez Lozoya, hereby appeal to the United States Court of Appeals for the Ninth Circuit from the "Order Restraining Federal Officers From Testifying in State Criminal Proceedings" which order enjoining respondents was entered in this action on January 10, 1957.

Dated: January 11, 1957.

LAUGHLIN E. WATERS,
United States Attorney;

LOUIS LEE ABBOTT,
Assistant U. S. Attorney,
Chief, Criminal Division;

/s/ JOSEPH F. BENDER,
Assistant U. S. Attorney,
Attorneys for Respondents.

[Endorsed]: Filed January 11, 1957. [68]

[Title of District Court and Cause.]

MOTION TO SUSPEND ORDER OR
INJUNCTION PENDING APPEAL

Come Now the respondents, Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller, and move the above-entitled court to suspend the "Order Restraining Federal Officers From Testifying in State Criminal Proceedings," which injunction was ordered by the Honorable Thurmond Clarke on January 10, 1957, pending the appeal thereof, for the following reasons:

I.

To prevent irreparable injury to respondents by denial to them of due process of law under the Fifth Amendment of the Federal Constitution, and their right of free speech and to express themselves as guaranteed by the First Amendment, and by subjecting them to possible punishment by fine or imprisonment, or both, for failure to obey the process and lawful order of the Los Angeles Municipal Court. [69]

II.

Respondents have filed their notice of appeal of said order or injunction.

Serious questions have been posed by the grant of said order, viz.:

(a) Does a District Judge have jurisdiction in a criminal case, subsequent to acquittal of defendant, to issue an injunction?

(b) Can a Judge of the District Court, subsequent to the withdrawal of marihuana from evidence, order a federal narcotics agent to turn over said marihuana to the Clerk of his Court with no showing that said marihuana was unlawfully obtained by said agent?

(c) Can a Judge of the District Court enjoin federal narcotics agents from testifying in State Court proceedings, with no showing that the evidence to be given by them was unlawfully secured?

(d) Can the Federal Court enjoin the State Court without notice to that court or to the prosecuting officials of the State?

(e) Can the District Court make a finding of fact concerning allegations of beatings and torture without the taking of any evidence thereof?

Dated this 11th day of January, 1957.

LAUGHLIN E. WATERS,
United States Attorney;

LOUIS LEE ABBOTT,
Assistant U. S. Attorney,
Chief, Criminal Division;

/s/ JOSEPH F. BENDER,
Assistant U. S. Attorney,
Attorneys for Respondents.

Points and Authorities in Support of Motion

I.

The Court may suspend an injunction during the pendency of an appeal upon such terms as it considers proper.

Rule 62(c) of Federal Rules of Civil Procedure;

Lineker v. Dillon

(D.C. Calif., 1921), 275 Fed. 460, 470.

II.

When an appeal is taken by an officer or agency of the United States, no bond shall be required.

Rule 62(e) of Federal Rules of Civil Procedure.

III.

When "a federal agent has violated the Federal Rules governing searches and seizures * * *" the Federal Court may enjoin the federal officer from using "the fruits of his unlawful act" as "the basis of testimony in the State Court * * *"

Rea v. United States,
350 U. S. 214.

In the instant Lozoya matter, petitioner has never claimed that the marihuana was obtained from him unlawfully.

IV.

Where the same act is an offense against both State and Federal Governments, its prosecution and

punishment by the latter after prosecution and punishment by the former is not double jeopardy.

United States v. Lanza,

260 U. S. 377, and in particular pp. 383,
384 and 385.

V.

The issue of double jeopardy cannot be pleaded or raised by the defendant until the appropriate time in the State proceedings.

In re Lozoya, 146 A.C.A. 760.

[Endorsed]: Filed January 11, 1957. [71]

[Title of District Court and Cause.]

AFFIDAVIT OF JOSEPH F. BENDER

United States of America,

Southern District of California—ss.

Joseph F. Bender, being first duly sworn, states:

That affiant is an Assistant United States Attorney.

That affiant appeared as one of the counsel for respondents at the hearing on order to show cause in the captioned action, before the Honorable Thurmond Clarke on January 10, 1957.

That the only written documents or evidence presented to the court at said hearing consisted of the

Order to Show Cause, the Petition of Refugio Gonzalez Lozoya, and Points and Authorities, filed in said proceeding January 4, 1957, and the Brief and Points and Authorities of respondents, filed January 7, 1957.

That no other evidence by affidavit or testimony was offered [72] or received at said hearing.

That no evidence of alleged beatings or torture by respondents or anyone, was offered or received in said hearing.

Further affiant sayeth not.

/s/ JOSEPH F. BENDER,
Assistant U. S. Attorney.

Subscribed and sworn to before me this 11th day of January, 1957.

/s/ JOHN A. CHILDRESS,
Clerk, U. S. District Court for the Southern District of California.

[Endorsed]: Filed January 11, 1957. [73]

In the United States District Court, Southern District of California, Central Division

No. 25033 Criminal

UNITED STATES OF AMERICA,

Plaintiff,

vs.

REFUGIO GONZALES LOZOYA,

Defendant.

Honorable Thurmond Clarke, Judge Presiding.

REPORTER'S TRANSCRIPT
OF PROCEEDINGS

Tuesday, July 17, 1956—9:30 A.M.

Appearances:

For the Plaintiff:

LAUGHLIN E. WATERS,

United States Attorney; by

JOSEPH F. BENDER,

Assistant United States Attorney.

For the Defendant:

DAVID MARCUS, ESQ.

The Court: The Lozoya case.

Mr. Marcus, are you going to waive jury or have a jury trial?

Mr. Marcus: At the moment, your Honor, it is a jury trial. May I have a moment to talk to the defendant?

The Court: Well, we are ready to proceed.

Mrs. Bulgreen, I think in your case we can let the jurors go into Judge Hall's court and transfer the case in there.

And, Mr. Bender, we will hold your case while Mr. Marcus talks to the defendant. Is that satisfactory?

Mr. Bender: That is perfectly satisfactory.

The Court: We are going to take a chance and send the jury over there. We may have to bring you back. I was looking at Mr. Marcus over there. He wants to talk to his client. Anyway, we will send the jury over to Judge Hall's court on Mrs. Bulgreen's case. But we may have to bring you back. The jury may go over there now and the defendant may go over there now with her counsel.

(A recess.)

The Court: All right, we have the waiver. You may call your first witness. Go ahead. [3*]

Mr. Bender: Your Honor, I am advised that the Government's exhibit, the marijuana, was mailed yesterday and hasn't arrived yet.

The Court: We can go ahead without it and we will get it this afternoon or maybe tomorrow morning, if necessary.

Mr. Bender: The Government is inclined to waive its opening statement. Has the court read the trial memorandum?

The Court: Yes.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

Mr. Bender: Well, that will certainly cover the matter.

Mr. Marcus: May I ask the court to invoke the rule, your Honor please, to exclude the witnesses?

The Court: He would like to have the witnesses——

Mr. Bender: Sequestered?

The Court: Yes.

How many do you have here?

Mr. Bender: We have only one witness here at the present time.

The Court: Only one here. I will ask Mr. Bender when they come in to have them remain in Judge Hall's court so that he can find them. So we will know where they are.

Mr. Bender: All right. That applies, then, to the defendant's witnesses?

The Court: Well, if you want to invoke the rule as to them, too, certainly.

Mr. Bender: Certainly. It is a two-way street. [4]

The Court: All right.

All those who are going to testify, have them remain in the next court here, in Department 1, right alongside us, so that we can find them if we want them. Just those who are going to testify.

(Whereupon persons leave the courtroom.)

The Court: All right.

Mr. Bender: Your Honor, the Government requests that Mr. Fisher, the clerk, mark this Government's Exhibit No. 2, the stipulation of facts and order thereon for identification only.

Have you seen this?

Mr. Marcus: The one I signed?

Mr. Bender: At this time, the Government offers as Government's Exhibit 2, a stipulation of facts and proposed order thereon, and requests that the court, on page 2 of the stipulation, approve the stipulation of facts, in accordance with, as the court knows the Federal Rules requiring approval of the stipulation before it can be filed.

The Court: All right.

Mr. Marcus: Mr. Bender, I believe, in view of your statement to the court that the exhibit referred to in the stipulation having not arrived yet, that it would be inopportune at this moment to have the court approve the stipulation. I think, in view of the fact that the exhibit is not here—— [5]

The Court: We don't have to approve it until the exhibit gets here.

Mr. Marcus: That is it.

The Court: It will probably come in the mail today, because you are prepared for trial today.

Mr. Bender: Yes.

Your Honor, if I may point out, subparagraph B of the stipulation, the scope of the stipulation is only that this stipulation is as to the qualifications of the chemist, that he is an expert witness; that he would testify that, in his opinion, it was marijuana; and that this Exhibit 1 would be identified by a number. Certainly all you stipulate to is that he would be identified. If it is not produced, it can't be identified.

Mr. Marcus: The analysis made by R. F. Love,

reveals that said Exhibit 1 for identification consists of approximately nine and a half pounds of marijuana. But there is no exhibit yet. How could we, in conformance with good practice, present the stipulation to the court where there is no exhibit?

The Court: In other words, you want to wait until the exhibit gets here?

Mr. Marcus: That's right, your Honor. Suppose something happens to the exhibit. I have never seen it.

The Court: Well, we can wait until it gets here.

Mr. Bender: Has it been received in evidence, your Honor, [6] or are you waiting to receive it into evidence?

The Court: Why don't we mark it for identification?

Mr. Bender: That has been done.

The Court: In view of Mr. Marcus' statement.

Mr. Bender: I observe, your Honor, that the wife has returned to the courtroom. Is she going to testify?

Mr. Marcus: She may testify.

I want you to wait next door.

The Court: Yes, if you would listen. Just go next door.

We told her to wait in Department 1. We couldn't let her testify if she stayed in here.

Mr. Bender: The Government calls Jose Joe Ramirez as its first witness, your Honor.

JOSE RAMIREZ

called as a witness on behalf of the plaintiff, being first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: Jose Ramirez.

Direct Examination

By Mr. Bender:

Q. Mr. Ramirez, you are a college graduate, are you not? A. Yes, sir.

Mr. Marcus: It is immaterial whether he is a college graduate or not, your Honor.

The Court: Well, I think he wants to give his background [7] of education.

Q. (By Mr. Bender): What is your profession or your occupation?

A. I am a Narcotics Agent attached to the Bureau of Narcotics, Treasury Department.

Q. For how long have you been connected with the Narcotics Bureau?

A. Since March of 1952.

Q. In what capacity were you connected or concerned with them at that time?

A. At that time I was employed as an agent trainee until——

Q. Did you subsequently become a full-fledged Federal Narcotics Agent? A. Yes.

Q. When? A. August 1, 1954.

Q. Have you been so employed and engaged since that time to the present? A. I have.

(Testimony of Jose Ramirez.)

Q. Directing your attention now to on or about May 17, 1956, what, if anything, occurred at that time with reference to this case?

Mr. Marcus: I object to that as being too broad. It is not directed to any particular incident or [8] event.

Mr. Bender: All right, your Honor, I can be more specific. I thought I was saving time.

The Court: All right.

Q. (By Mr. Bender): Directing your attention to approximately 7:00 o'clock in the evening of May 17, 1956, in the vicinity of Beverly Ranch Market in Montebello, California, and specifically to, I believe, in the vicinity of the intersection of Beverly and Poplar Streets, were you present there at that time, at approximately that time?

Mr. Marcus: Just a moment. That is objected to as being leading and suggestive, your Honor. It is compound. He has three parts to that question: the time and the place and he is assuming these facts at this time, your Honor.

The Court: Well, no, I'll overrule the objection. I think it is compound, but it might save time. We will split them up in the next series you have, Mr. Bender.

Mr. Marcus: I didn't want to rush this too fast.

The Court: All right.

Q. (By Mr. Bender): Mr. Ramirez, have you been to the Beverly Ranch Market in Montebello?

A. I have.

Q. When? A. On May 17, 1956.

(Testimony of Jose Ramirez.)

Q. At approximately what time?

A. At approximately 7:00 p.m. [9]

Q. What did you do on arrival at this time and place?

A. Upon arrival I parked the official government vehicle in the parking lot which is behind the Beverly Ranch Market.

Q. Did you remain there or did you leave within the next half hour?

A. I remained there until approximately 7:30.

Q. Well, what occurred at approximately 7:30, if anything?

A. At approximately 7:30, a cream-colored Chevrolet entered the parking lot, parked in front of my government vehicle. I walked to the car and spoke to the defendant Lozoya.

Q. What approximate year was this Chevrolet?

A. It was approximately a 1941.

Q. Was it a sedan or coupe, or do you recall?

A. It was a sedan.

Q. Was anyone in the automobile?

A. Yes, sir; the special employee of the Federal Government was there.

Q. And who else?

A. And myself and the defendant Lozoya.

Mr. Marcus: With the court's permission, may the reporter go back a couple of questions? I didn't get the answer of the witness. [10]

The Court: All right.

Mr. Bender: I will be glad to rephrase the question.

(Testimony of Jose Ramirez.)

Mr. Marcus No; it isn't for that purpose. I just didn't hear it.

The Reporter: Which part, Mr. Marcus?

Mr. Marcus: About three questions back.

(Whereupon the reporter read the record as follows:)

"Q. Did you remain there or did you leave within the next half hour?

"A. I remained there until approximately 7:30.

"Q. Well, what occurred at approximately 7:30, if anything?

"A. At approximately 7:30, a cream-colored Chevrolet entered the parking lot, parked in front of my government vehicle. I walked to the car and spoke to the defendant Lozoya.

"Q. What approximate year was this Chevrolet?

"A. It was approximately a 1941.

"Q. Was it a sedan or coupe, or do you recall?

"A. It was a sedan.

"Q. Was anyone in the automobile?

"A. Yes, sir; the special employee of the Federal Government was there."

Mr. Marcus: That's the part I wanted. "Employee" was the word?

The Reporter: "Special employee." [11]

Mr. Marcus: Special employee.

Q. (By Mr. Bender:) Mr. Ramirez, did you say "special employee"? A. Yes, sir.

Q. What occurred at this time?

A. I walked to the driver's side of the mentioned

(Testimony of Jose Ramirez.)

vehicle and spoke to the defendant Lozoya. I asked him if he had something for me, and he said "Yes."

I asked him, "How much do you have?"

And he said, "Ten pounds."

I asked him, "How much will it cost me?"

And he said, "\$10 a pound"—pardon me—" \$60 a pound."

I asked him, "Is the marijuana good?"

And he said, "Yes." He said, "There is no beef about my stuff."

I then asked him if he could give me a cut, and he said no, he couldn't do it this time because he had to have so much to pay when he crossed the border with it.

I then asked him, "If you give me a cut, I will be your steady customer from now on."

And he said, "Well, I can't do it this time. Maybe next time."

And I said, "Well, how much will you let me have it for? \$50 a pound?"

He said, "No; 53." [12]

I said, "Well, that's all right. Let's see the stuff, if it is good."

Q. Did you say the 53 was for the ten pounds?

A. Well, that was for the future transactions, yes.

Q. How much did you discuss as price for the present transaction? A. \$60 a pound.

And he said, "Wait a minute," and he looked around the area a few minutes, and then I said,

Testimony of Jose Ramirez.)

"Well, let's get it, because I want to see if it's good."

So the defendant backed the car adjacent to mine, which would leave a space of about four feet. He then walked to the rear of his vehicle and asked me where I wanted it. I said, "In the trunk of my car." He then walked over and unlocked my trunk, and he opened his trunk and removed from the trunk of his vehicle a burlap sack, which he placed in the trunk of my automobile.

I then closed the door, the trunk lid on my car and was in the act of paying the defendant some money when the other agents arrived and placed him under arrest.

Mr. Marcus: May that portion of his testimony, that, "I was in the act of paying him some money" be stricken as being a conclusion of the witness, your Honor?

The Court: All right, it may go out.

Q. (By Mr. Bender): What were you doing at the time the [13] defendant was arrested?

A. I had my money in the left hand and I had a few bills extracted with my right.

Q. Would you describe the position of your hands?

A. Yes. I was going to go like that (indicating). I had my hand out, with the other——

Q. With the bills in it? A. Yes.

Q. Which hand?

A. I had it in my right, and when the agents arrived——

(Testimony of Jose Ramirez.)

Q. To whom were you directing your right hand? A. To the defendant Lozoya.

Q. Was it pointed toward him? A. Yes.

Q. Apporximately how far were you from him at this time?

A. About as close as this gentleman is here (indicating), closer perhaps.

Q. The court reporter?

A. Perhaps—yes, closer; we were right next to each other.

Q. Pardon me.

A. We were right next to each other.

Q. At this time you say it was about 7:30 in the evening? A. Yes, sir. [14]

Q. Was it daylight or dark?

A. No; it was daylight.

Q. Do you recall about what time it got dark that evening, May 17th?

A. No; I don't recall the exact time, but it must have been a little after 8:00, or 8:00 o'clock.

Q. This 1941 Chevrolet that you testified that the defendant and another individual were in, who was driving the 1941 Chevrolet when it came into the Beverly Ranch Market?

A. Defendant Lozoya was driving the car.

Q. Where was this other individual seated in the car?

A. He was seated in the front passenger side.

Q. Where was the 1941 Chevrolet automobile when you first saw it?

A. When I first observed this car, it was travel-

(Testimony of Jose Ramirez.)

ing east on Beverly. I just caught a glimpse of it just before he stopped for the red light.

Q. And then did it go out of your view for a moment? A. Yes; it did.

Q. What obstructed your view of it? What came between you and the car?

A. The building, the market building.

Q. When and where did you next see it?

A. Well, a few moments later I observed it on Poplar, just before he turned into the market parking lot. [15]

Q. Then the entrance they turned in onto the market was off Poplar Street; is that correct?

A. Yes.

Q. Where was the car driven, this 1941 Chevrolet, as it turned in?

A. It was driven into the lot directly in front of my vehicle.

Q. What occurred then?

A. That is when we held the conversation.

Q. Did the 1941 Chevrolet—was it stopped at approximately in front of your vehicle?

A. Yes.

Q. Approximately how long did you engage in this conversation with the two individuals?

A. For approximately five minutes, I would say.

Q. Did anything happen to the 1941 Chevrolet? Was it moved or anything of that nature after or during the conversation?

A. Well, after the conversation he backed it adjacent to mine.

(Testimony of Jose Ramirez.)

Q. How close?

A. Approximately four feet.

Q. You mean he parked it parallel to yours?

A. Yes.

Q. And was that before the removal of the burlap sack [16] from the trunk of his car?

A. It was.

Q. Directing your attention back momentarily to approximately 7:00 o'clock, or a little after 7:00, were there any covering agents in the vicinity that you observed?

A. Yes, sir. I observed all agents. They were approximately——

Q. Whom did you observe?

A. I observed Agent Gullen and Agent Frias—pardon me—Agent Freeman, who were standing on the sidewalk beside the Beverly Ranch Market, a distance of approximately 50 feet. I saw Agent Goodman, Agent Cantu, and Agent Miller, directly across the street in the lot of a service station.

Q. That was Goodman, Cantu and Miller?

A. Yes, sir.

Q. After the defendant placed this burlap sack into the trunk of the car, did you make any other gesture or anything other than and in addition to the payment of the money or the attempted payment of the money?

A. Yes, sir. Immediately upon the defendant placing the burlap sack in the trunk of the government vehicle, I hurriedly tore one of the paper

(Testimony of Jose Ramirez.)

sacks open and I observed it was a green leafy substance resembling marijuana.

I then gave the prearranged signal, which was the dropping of a banana which I had been eating. I dropped it [17] on the floor, and that was the prearranged signal that the evidence had been delivered and that I thought it was marijuana.

Mr. Marcus: Just a moment. I move that that last portion be stricken, your Honor, as being a conclusion of this witness.

Mr. Bender: The portion after where, counsel?

Mr. Marcus: "I dropped the banana."

The Court: That part may go out, just that part.

Mr. Bender: It is my understanding, your Honor, that the testimony "I dropped the banana" has remained in, but it is the subsequent testimony that has been stricken.

The Court: That's right.

Q. (By Mr. Bender): Who was present at the time of the arrest of the defendant? Name all of the individuals who were present?

A. Yes, sir. Agent Gullen and Agent Freeman, Agent Goodman, Agent Cantu, and Agent Miller, and the special employee.

Q. And yourself?

A. And myself; yes, sir.

Q. And the defendant? A. Yes.

Mr. Marcus: I submit that that does not answer the question. He was asked to name all persons present. [18]

Mr. Bender: All right, I'll withdraw the question.

(Testimony of Jose Ramirez.)

The Court: All right.

Q. (By Mr. Bender): And I will ask you to state what persons were present at the arrest of the defendant?

Mr. Marcus: Well, he has answered part of it.

Mr. Bender: Yes.

Mr. Marcus: I think he should be required to answer the rest of it now, and not be permitted to withdraw the question after he has answered part of it.

Mr. Bender: Counsel, that is an unusual rule of law.

The Court: I will let it remain.

Q. (By Mr. Bender): Was there any conversation—did anyone say anything in the presence of the defendant at or immediately subsequent to his being placed under arrest? A. Yes, sir.

Q. What was said? What was stated in his presence and by whom?

A. Agent Goodman; upon arriving, he asked the defendant where had he obtained the burlap sack that he placed in my government vehicle.

Q. What did the defendant say?

A. The defendant said, "What sack? I didn't put any sack over there," or words to that effect.

Agent Goodman then said, "Well, we just saw you put a sack in there." [19]

Q. Up to this time had you advised or told the defendant that you were a Federal Narcotics Agent?

A. No; I did not.

Q. When was it that you first advised the de-

(Testimony of Jose Ramirez.)

defendant that you are a Federal Narcotics Agent—
what date?

A. I advised the defendant Lozoya on May 24th,
when I made a marijuana demand order form.

Q. Where did you make this demand?

A. At the county jail.

Q. At approximately what time? Morning or
afternoon?

A. I believe it was close to noon. I am not posi-
tive.

Q. Who was present besides yourself and the de-
fendant, if anyone, when you made this demand?

A. I believe it was Agent Freeman.

Q. What did you say to the defendant, if you
recall?

A. I said, "Hello, Lozoya." And he didn't
answer. I took out my badge and commission and I
said, "This is to notify you that I am a Federal
Narcotics Agent, and it is my duty to make certain
demands on you." I then made a demand, advised
him that every person who handles or transfers
marijuana has to produce an official government
form.

Q. Did he produce the form? A. No, sir.

Q. Did he say that he had it?

A. Yes; at first he said he had it, and then I
said, [20] "Well, within eight days you have to
show a copy of this in the office of the Federal Bu-
reau of Narcotics, Room 1755." He then said that
he had no form.

(Testimony of Jose Ramirez.)

The Court: We'll stop and take the morning recess at this time of about ten minutes.

(Recess.)

The Court: Go ahead. Do you want the last question, Mr. Bender?

Mr. Bender: Yes, your Honor.

The Court: All right.

(The reporter read the record as follows:)

"Q. Did he produce the form?

"A. No, sir.

"Q. Did he say that he had it?

"A. Yes; at first he said he had it, and then I said, "Well, within eight days you have to show a copy of this in the office of the Federal Bureau of Narcotics, Room 1755. He then said that he had no form."

Q. (By Mr. Bender:) Mr. Ramirez, approximately where were you standing just before the other agents came up and made the arrest?

A. The vehicles were facing north. I was standing approximately on the left rear quarter panel which would be right beside the left rear fender. The defendant was standing—— [21]

Q. Of which car?

A. Of the government vehicle. We were between the two cars. The defendant was facing me at an approximate distance of two or three feet.

Q. He was facing in which direction then?

(Testimony of Jose Ramirez.)

A. He was facing south, and I was facing north.

Q. Which direction did the arresting officers approach from?

A. They approached from the north, walking toward us, walking south.

Q. In other words, they approached from behind the defendant? A. Yes, sir.

Q. After the defendant was placed under arrest, did you accompany the defendant anywhere?

A. No. I was conveyed in a separate automobile with Agent Goodman to the Bureau of Narcotics office.

Mr. Marcus: I'm not hearing any of these answers at all, your Honor. He speaks too low.

The Court: Speak a little louder, please, Mr. Ramirez.

The Witness: I was conveyed to the Bureau of Narcotics office by Agent Goodman.

Q. (By Mr. Bender): At the Bureau of Narcotics office, were you placed in any interrogation room or other room with the defendant? [22]

A. Yes; I was placed in the same room with the defendant.

Q. At this time had you told him you were a Federal Narcotics Agent? A. No; I had not.

Q. Had anyone told him this in your presence?

A. No.

Q. What occurred in this room at the Federal Narcotics interrogation room?

A. I was placed in the same room with the defendant. I made an attempt to talk to him. He said,

(Testimony of Jose Ramirez.)

"Sh-h," and put his finger up to his lips and he pointed up at the fan on the wall. He then refused to say anything else.

Q. He then said nothing?

A. He then said nothing further.

Q. What did you do with the contents and this burlap sack that, as you testified, was placed in the trunk of the government car by the defendant? What did you do with it?

A. I weighed and initialed that evidence, and it was mailed to the ATU chemist in San Francisco, on May 18th.

Q. Did you mail it? A. Yes, sir.

Q. You referred to this other man as a "special employee." By that did you mean he was paid any money?

Mr. Marcus: Just a moment. That calls for a conclusion [23] of the witness. He has already given his answer. What he means is a question for cross-examination.

The Court: I'll overrule the objection. You may answer.

The Witness: We refer to anyone who assists our Bureau in any capacity as a special employee.

Mr. Bender: You may cross-examine.

Cross-Examination

By Mr. Marcus:

Q. Who employed him?

A. Well, I guess our Bureau, our office did.

(Testimony of Jose Ramirez.)

Q. Well, did you employ him?

A. Well, he was assisting me, yes.

Q. My question was, did you employ him?

A. I don't believe I understand the word "employ."

Q. You said he was a "special employee." Now my question is, did you employ him?

A. He was assisting our Bureau, yes. He was——

Q. That isn't my question.

A. He was assisting me in this case.

Q. I didn't ask you whether he was assisting you. I asked you if you hired him, if you employed him?

A. I'm afraid I will have to have a definition of the word "hired."

Q. Well, that's very simple. You are a [24] college graduate. Tell me what you mean by the word "hire"?

A. By "hire" I mean someone who comes in and perhaps signs contracts to do a certain job, I suppose, at which time he will be guaranteed a certain sum upon completion of his job.

Q. Well, you told the Judge a while ago, when your attorney asked the question here—the Government asked you the question, and you said that he was a special employee of the Federal Government.

A. Yes, sir, and I——

Q. Just a minute, please. Did you say that?

A. Yes, sir.

(Testimony of Jose Ramirez.)

Q. Now my question is who employed him as a special employee of the Federal Government?

A. I presume I did.

Q. Well, let's not presume. I want you to tell the court if you hired him.

A. I'm afraid I don't know how to answer that question.

Q. Well, that is very simple. Do you know a man by the name of Johnny Villas?

A. Yes; I do.

Q. How long have you known him?

A. I don't recall. Approximately six to eight months, I would say.

Q. Where did you first meet him? [25]

A. I met him in—I believe it is West Whittier.

Mr. Bender: The Government objects to the question as being irrelevant and immaterial, your Honor.

Mr. Marcus: I am going to tie it up. I can't ask all the questions at one time.

The Court: I'll overrule the objection.

Mr. Bender: Further, the identity of the informer is confidential matter.

Mr. Marcus: I didn't ask him the identity. I know who he is.

The Court: All right. You may proceed.

Q. (By Mr. Bender): You say you met him at Whittier?

A. I believe it is West Whittier, yes.

Q. In West Whittier. And at that time you were an officer, weren't you?

A. Yes, sir.

(Testimony of Jose Ramirez.)

Q. You know that Johnny Villas lives in West Whittier, don't you?

A. No; I do not know where he lives now. I believe at the time he was living in this area I refer to as West Whittier.

Q. You knew he was living in West Whittier at the time you met him, you say about six months ago; is that right?

A. I really don't know. It was about eight months.

Q. Eight months ago. Now, the question is, [26] did you know where he lived at that time?

A. Eight months ago?

Q. Yes, sir.

A. Subsequently I found out where he lived, yes.

Q. You have been to his home, haven't you?

A. Yes.

Q. Let's answer the questions directly, Mr. Ramirez, will you?

Mr. Bender: Counsel, I submit that he answered "Yes." How much more direct can you answer the question?

Mr. Marcus: I have asked him three times now where he lived.

Q. You knew his home, didn't you?

A. Yes.

Q. You have been there to his home?

A. Which period are you talking about?

Q. At any time.

A. When I first met him, yes.

(Testimony of Jose Ramirez.)

Q. And he lived in West Whittier, didn't he?

A. I believe it is West Whittier.

Q. Well, where did you go when you went out there to see him at his home? Did you go to West Whittier?

A. I believe that area where he lives is West Whittier. However, I haven't checked my records, because I said it is West Whittier or Whittier. [27]

Q. To what address did you go when you went out there to see him?

A. 5800 on Bonita Street.

Q. 5800? West Whittier, isn't it?

A. I believe so.

Q. I didn't ask you if you checked your records. I asked you where he lived. You went on 5800 West Whittier, or Bonita Street, didn't you?

A. Yes; I went to 5800 Bonita.

Q. I want you to be frank with me in these answers, please, and if you don't know them to answer them directly. You knew Johnny Villas as a narcotic peddler, didn't you? A. Yes.

Q. Now, you arrested Johnny Villas, didn't you?

A. Yes.

Q. You knew he had been engaged in peddling marijuana prior to the time you met him eight months ago, you say, didn't you?

A. Not prior to that.

Q. Well, at least on that date? A. Yes.

Q. And you placed him under arrest and filed charges against Johnny Villas, didn't you?

A. Yes.

(Testimony of Jose Ramirez.)

Q. And you prosecuted or assisted in the [28] prosecution of Johnny Villas, didn't you?

A. No, sir. He plead guilty.

Q. Well, you came to court, didn't you?

A. Yes, sir.

Q. You were in court at the time the hearing was conducted, weren't you?

A. I don't believe I was in the courtroom when he pleaded guilty.

Q. You are not sure of it, are you?

A. No.

Q. Do you remember a boy by the name of Moreno was invloved in that deal, too?

A. Yes.

Q. Do you remember that I was attorney of record and appeared in court for Moreno at the time you were there? A. Yes.

Q. Now you remember being in court, don't you?

A. Yes.

Q. You knew that Mr. Moreno's reputation at the time was a marijuana peddler in West Whittier, didn't you?

A. West Whittier and another area in the San Gabriel Valley.

Q. In the San Gabriel Valley? A. Yes.

Q. You knew there was a trial involving this boy Moreno [29] that I represented, didn't you?

A. Yes.

Q. There was a trial before Judge Carter?

A. Yes.

Q. And isn't it a fact that you were talking to Mr. Villas during the period of his prosecution on

(Testimony of Jose Ramirez.)

that case, during the time that the case was pending before Judge Carter? A. No, sir.

Q. You didn't see him in court at all?

A. Johnny Villas? No, sir.

Q. Johnny Villas. Didn't you see him in court at the time he entered a plea to the judge?

A. No, sir. As I stated, I don't believe I was here when he entered a plea. I don't believe I was in the courtroom.

Q. Do you remember the case being continued on two or three occasions? A. Yes.

Q. And you were in court during those occasions, weren't you?

A. No, sir, I don't believe I was.

Q. Are you sure, or just don't remember?

A. I don't recall.

Q. Now, you knew that Villas had been convicted on previous occasions in matters involving marijuana, didn't you? [30]

A. No, sir.

Q. You had his record at the time in the courtroom, didn't you? A. Yes, sir.

Q. And the record you had at that time disclosed that he had been convicted of the possession of marijuana on the prior occasion?

A. No, sir, I don't believe he was ever convicted prior to the case.

Q. Can you get your records, sir, to refresh your memory later on in the day with respect to Johnny Villas, an employee of the Federal Government?

Mr. Bender: The Government objects to this

(Testimony of Jose Ramirez.)

line of questioning on the grounds that it is totally irrelevant and immaterial, your Honor.

The Court: I'll sustain the objection.

Mr. Marcus: I'm going to show the bias, the prejudice, the interest of Johnny Villas and connect him up with it. I haven't asked the connecting question yet, but I propose to show who Johnny Villas is.

Mr. Bender: The Government submits that if that were true and Johnny Villas were in on the transaction, that wouldn't affect this.

Mr. Marcus: That would go to the credibility of this witness. [31]

The Court: As to his record, I will sustain the objection.

Mr. Marcus: Very well, your Honor.

Q. How long prior to May 17th had you seen Johnny Villas?

A. I would say approximately two weeks.

Q. Had you seen him during the period of the two weeks? A. Yes, sir.

Q. Had you talked to him during the period of the two weeks? A. Yes, sir.

Q. How often during that two weeks' period had you talked to him?

A. I believe I talked to him over the telephone about two times, and I saw him personally once.

Q. Did you tell Johnny Villas that he would have to help because Judge Carter had granted him straight probation?

(Testimony of Jose Ramirez.)

A. No, I did not. I didn't know he had granted him probation.

Q. Do I understand, sir, that you are telling this court you didn't know Johnny Villas was on probation at the time?

A. No, sir, I don't believe so.

Q. And that was the case in which you were involved and had made an arrest on, and you don't know what disposition [32] was made of that case?

A. As to the defendant John Villas, no.

Q. You had made an arrest on it, hadn't you?

A. Yes.

Q. And you had appeared in court on several occasions concerning that case? A. Yes.

Q. And you didn't know what disposition was made of it?

A. I do not know whether disposition was made prior or after.

Q. Prior or after what?

A. This present case you are talking about.

Q. Prior or after this, a case of the arrest of this defendant Lozoya?

A. What I am trying to say is, I do not recall when he was sentenced. I would have to check my records.

Q. Mr. Ramirez, do I understand you to state under oath now that you don't know what disposition was made of the Villas case at the time you talked to him some two weeks before May 17th? Do I understand that to be your testimony?

7

(Testimony of Jose Ramirez.)

A. No, sir, I do not recall when he was sentenced.

Q. I didn't ask you whether you recall when he was sentenced. I am asking you whether or not you know what disposition was made of his case at the time that you talked to him previous—during the two weeks' period prior to [33] May 17th?

A. No, sir, I don't believe I did know the disposition.

Q. Well, you are not sure, though?

A. That is right.

Q. You are not telling this court under oath that you do not know?

A. Well, I do not know. I don't recall.

Q. You don't recall? A. That's right.

Q. I understand that you tell us now that you didn't also know that he had a prior record, prior to his conviction before Judge Carter of narcotics?

A. As best I can recall, I do not believe that he had a prior conviction.

Q. Did you contact Villas or did he contact you two weeks prior to this date of May 17th?

A. I believe he called me.

Q. On that date did you know that he was on probation?

A. I don't know, sir, as I stated before.

Q. Just answer yes or no, please.

A. I don't know.

Q. You don't know? And then on that date did you make him an employee of the Federal Government?

A. Well——

(Testimony of Jose Ramirez.)

Q. Yes or no. [34] A. I do not recall.

Q. When did you make him a special employee of the Federal Government?

A. During that two weeks' period we held a conference.

Q. Just what date was it? That is all I am asking you. A. What date?

Q. What date was it you made him a special employee of the Federal Government?

A. I do not recall.

Q. Well, was it, to the best of your memory, during that two weeks' period? A. Yes.

Q. How long prior to May 17th was it?

A. I do not recall.

Q. You don't recall that either?

A. No, sir.

Q. Well, what words did you use to this Mr. Villas to tell him that he was a special employee of the Federal Government?

Mr. Bender: Your Honor, the Government objects to this line of questioning again on the grounds that this specific question is irrelevant and immaterial; it has nothing to do with any of the issues in this case.

Mr. Marcus: I assure this court I will tie it up.

The Court: I'll overrule the objection. [35]

The Witness: I don't believe that there is any specific words that I used or anyone uses.

Q. Did you tell him he was a special employee of the Federal Government?

A. Well, yes. Well, we usually refer to people—

(Testimony of Jose Ramirez.)

Q. Not what you usually do. I want to know what you told to Villas?

A. I do not recall any verbatim conversation with the defendant, with this person Villas.

Q. Your testimony was that he was a special employee of the Government. You testified that you made him a special employee. I'm asking you how you made him that special employee?

A. By anyone that assists our Bureau.

Q. Did you have any instructions? Who is your superior officer?

A. Agent Chappell.

Q. What is his name?

A. Chappell—C-h-a-p-p-e-l-l.

Q. Where is his office located? A. 1755.

Q. Of this building? A. Yes, sir.

Q. Did you advise your superior officer that you were going to make a special employee of the Federal Government of [36] this man Villas?

A. Yes, sir, I believe so.

Q. Did you do that in writing? A. No, sir.

Q. That was just a conversation?

A. Yes, sir.

Q. Did you receive any instructions from your superior officer to make him a special employee?

A. Prior to my conversation or after?

Q. Any time, did you receive instructions to make Mr. Villas a special employee of the Federal Government?

A. I don't recall Agent Chappell's—

(Testimony of Jose Ramirez.)

Q. Answer that yes or no. Did you receive any instructions to make him a Federal employee?

Mr. Bender: The Government objects to this question on the ground that it is irrelevant and immaterial. It doesn't tend to prove any issue in this case. It is totally outside the scope of the purpose and any reasonable expectation of being tied into this case, your Honor.

The Court: I'll overrule the objection.

Q. (By Mr. Marcus): Will you answer the question, please?

A. Well, from my interpretation of his conversation, yes.

Q. Relate the conversation.

Mr. Bender: The Government objects to this question on [37] the grounds that it is asking for hearsay statements; it is seeking, perhaps, confidential communications between agents of the Federal Bureau of Narcotics.

Mr. Marcus: I have a right to impeach this witness with respect to his statement on direct examination that this man was an employee of the Federal Government.

Mr. Bender: Well, he defined the meaning of "employee."

Mr. Marcus: Well, his definition, when he got back on the stand after the recess, was not binding upon me.

The Court: I'll overrule the objection.

The Witness: What was the question?

(Testimony of Jose Ramirez.)

(The reporter read the question as follows:
“Q. Did you receive any instructions to make him a Federal employee?”)

Q. (By Mr. Marcus): Just yes or no.

A. I believe I answered that by saying that my interpretation of his conversation was yes—would be yes.

Q. Well, whom did you receive the instructions from to make him a Federal employee?

A. Well, I imagine that that authority—

Q. I don't want your imagination at all. Just tell me who gave you the instructions to make Mr. Villas a special employee of the Federal Government?

A. That authority rests solely on the investigating officer, with permission of his Agent in [38] charge.

Q. You just told us you received instructions to make him a Federal employee. I'm asking you, who gave you the instructions to make him a Federal employee? A. (A pause.)

Q. Can you answer the question?

A. Not without explaining my answer.

Q. That calls for the name of a person who gave you the instructions. Who was it?

Mr. Bender: The witness has indicated that he can only explain his answer. He can't answer yes or no. Certainly that is permissible.

Mr. Marcus: I don't think that requires explanation at all. He said he received instructions to

(Testimony of Jose Ramirez.)

make him a Federal employee. I'm simply asking him for the name of the person who gave him that instruction?

Mr. Bender: The witness indicated it does need explanation. Where a witness says that, it is his right to give an explanation.

The Court: I will let him explain, if he wants to.

Mr. Marcus: Can he give the name of the person and then give his explanation?

The Court: Yes.

Q. (By Mr. Marcus): Will you do that, please?

A. Yes.

Q. Give me the name of the person? [39]

A. Agent Chappell.

Q. All right.

A. Every investigation is talked over with Agent Chappell—every aspect. The person who is going to assist our Bureau is told to him, and he usually says to go ahead and work it out.

Mr. Marcus: May the answer be stricken as being not responsive to the question, your Honor.

I'm not asking you what usually happens.

The Court: I'll let it remain.

Q. (By Mr. Marcus): Do you have any definite recollection at this time of talking to Agent Chappell, your superior officer, as I understand it, concerning the employment of Mr. Johnny Villas as a special agent?

A. I do not have any definite conversation that existed at that time. I do know that I spoke to him about it.

(Testimony of Jose Ramirez.)

Q. Do you have any definite recollection at this time of receiving any instructions from Mr. Chappell to employ Mr. Johnny Villas as a special agent?

A. Not any definite instructions, no, sir.

Q. So then you took it upon yourself to utilize the services of Mr. Johnny Villas, did you?

A. Yes, sir.

Q. Did you tell him what to do?

A. Yes, in a general sense, I sold him what to do. [40]

Q. You gave him instructions, did you not, during that two weeks' period? A. Yes.

Q. And you told him to contact you, did you?

A. Yes.

Q. Who was in the car with Mr. Lozoya, the defendant here, when that car drove up to that market? A. The special employee in this case.

Q. What is his name? Isn't that Johnny Villas that drove up there?

Mr. Bender: The Government objects on the grounds that the identity of the confidential informer is a matter that is not to be divulged. It is confidential. It is cited in our trial memorandum.

The Court: Yes, I think so.

Mr. Marcus: Your Honor, there is a case that just came out in the advance sheets before this last one. This is a Federal case from, I think it is, the Second Circuit, directly contrary to your position.

Mr. Bender: Then I submit, your Honor, counsel is submitting a case that has no authority in this case. The Ninth Circuit and the Supreme Court

(Testimony of Jose Ramirez.)

cases have the only binding precedent upon this case. The McGinnis case is a Ninth Circuit case.

Mr. Marcus: Your Honor, I am not asking for that. [41]

The Court: I'll overrule the objection.

You may answer.

Q. (By Mr. Marcus): Johnny Villas is the name of the man who was in that car, wasn't it?

The Witness: Shall I answer that, sir?

The Court: Yes.

The Witness: Yes, sir.

Q. (By Mr. Marcus): You knew that Johnny Villas had marijuana in his possession, didn't you?

A. On May 17th?

Q. Or prior to May 17th?

A. No, I did not.

Q. You were the one who arrested him for the possession of marijuana, didn't you?

A. If you are referring to eight months previously, yes.

Q. Well, at any time previously you knew that he was dealing with and had possession of marijuana, didn't you?

A. Eight months ago, yes. Approximately eight months ago, yes.

Q. You didn't know he had possession of marijuana six months ago?

A. I do not know. I was not in contact with him.

Q. You say he contacted you about two weeks before; is that right? [42]

A. Yes.

(Testimony of Jose Ramirez.)

Q. Where did you meet him?

A. The first time I met with him was in the office of the United States Attorney.

Q. Where?

A. Here in this Federal Building.

Q. Who was present at that time?

A. His attorney.

Q. What is his attorney's name?

A. I believe it is Graham.

Q. Byron Graham of El Monte?

A. Attorney Graham, from El Monte, yes.

Q. This was approximately two weeks prior to May 17th? A. Yes.

Q. And what else?

A. And Assistant United States Attorney Bender.

Q. Mr. Bender was in on that conversation?

A. Yes, and Agent Chappell.

Q. Isn't it a fact that in the course of that conversation you knew that Mr. Villas was on probation? This has just been about two months ago.

A. I do not recall, sir, at this time, whether I knew he was on probation or not.

Q. Well, wasn't there a conversation about getting him off probation by his attorney Mr. Byron Graham? [43]

A. Getting him off probation?

Q. To have his probation terminated——

A. No.

Q. ——in return for his assisting you?

A. No, I don't believe there was any conversation——

(Testimony of Jose Ramirez.)

Q. Are you sure there was not?

A. I am not sure, but I don't recall the conversation.

Q. After that conversation in the United States Attorney's office between Mr. Bender and yourself and Mr. Villas and the attorney, did you contact him after that? A. I believe he called me.

Q. Well, how many times did he call you between that date and May 17th?

A. Approximately two times.

Q. Always on the telephone?

A. No, sir. Approximately twice on the telephone, and once or twice in person.

Q. And where did you have these meetings in person?

A. One was in the area of Montebello—well, both of them would be in the area of Montebello.

Q. Any out in Whittier? A. No, sir.

Q. You had some conversations with Mr. Villas then? A. Yes, sir.

Q. Did you tell him about Lozoya? [44]

A. No, sir.

Q. You had a conversation about Lozoya, didn't you? A. Yes, sir.

Q. Did you and Villas cook up about meeting at the market? Yes, or no? A. Yes, sir.

Q. You had a conversation with Villas, did you not, about the meeting at the market in Montebello?

A. Yes, sir.

Q. How long before May 17th did you have that conversation with him?

(Testimony of Jose Ramirez.)

A. I think it was the same day.

Q. When was the name Lozoya mentioned the first time?

A. Mentioned in the meeting at the office of the United States Attorney Bender.

Q. Approximately how long prior to May 17th?

A. Approximately two weeks.

Q. Who mentioned the name first?

A. The defendant—pardon me—Attorney Graham, I believe, mentioned his name first, and Johnny Villas also mentioned it.

Q. Didn't Johnny Villas tell you that he worked at a plant—

A. Yes, sir.

Q. —where Mr. Lozoya had worked? [45]

A. I don't believe he said that Lozoya had worked there. At least, I don't recall him saying that.

Q. Did he tell you he was employed at a foundry where Mr. Lozoya had worked in 1951?

A. He told me that he, Johnny Villas, was employed in a foundry and that defendant Lozoya would come around occasionally.

Q. You don't recollect him telling you that he, the defendant, also worked there?

A. No, sir, I don't.

Q. You don't remember that?

A. I don't remember that, no.

Q. Did you at that time give instructions to Mr. Villas?

A. Yes, sir.

Q. You told him what to do in connection with

(Testimony of Jose Ramirez.)

this case, didn't you? A. Yes, sir.

Q. When is the next time you saw him?

A. I do not recall. I believe after that he talked to me over the phone and then I saw him.

Q. Did you continue to give him instructions, what he was to do?

A. Well, I just told him what to do that first day, that's all. [46]

Q. Now, did Mr. Lozoya tell you that he hadn't seen Mr.—pardon me—did Mr. Villas tell you he hadn't seen Mr. Lozoya for approximately two and a half years before May 17th?

A. No, he did not.

Q. He did not? A. No.

Q. Did he tell you that Mr. Lozoya and his wife were operating a restaurant? A. Yes.

Q. He told you that? A. Yes.

Q. Did he tell you that they wanted to sell the restaurant? A. No, he did not.

Q. Did he tell you what sort of restaurant it was?

A. No, he just told me it was a small cafe.

Q. Did he tell you at that time that he was anxious to get rid of the business?

A. Who was anxious?

Mr. Bender: Counsel objects to this on the grounds that it is irrelevant. What anyone would have told this Agent concerning being anxious to get rid of a business certainly could have no bearing on this case.

(Testimony of Jose Ramirez.)

The Court: Yes, I will sustain that objection to the [47] question.

Q. (By Mr. Marcus): Well, at that time you knew Mr. Lozoya was engaged in the restaurant business, didn't you? A. Yes.

Q. Did you instruct Mr. Villas what to do in connection with the restaurant?

A. No. I had no connection with the restaurant whatsoever.

Q. Did you instruct him to contact Mr. Lozoya?

A. I told him that if he saw——

Q. Yes or no? A. Yes.

Q. Did you tell him to contact Mr. Lozoya?

The Court: He has answered it yes.

Q. (By Mr. Marcus): Did you tell him to contact him in any way that Villas saw fit?

A. Yes, sir.

Q. Now, did you hear from Mr. Villas after that first conversation about contacting Mr. Lozoya?

A. Yes.

Q. Did he tell you that he had contacted Mr. Lozoya? A. Yes.

Q. Did he tell you he contacted his wife Mrs. Lozoya? A. No.

Q. Did he tell you he had contacted him at his place of [48] business? A. No.

Q. Did he tell you where he had contacted him?

A. No, he didn't.

Q. Did you then give him some further instructions or advice?

(Testimony of Jose Ramirez.)

A. No. He had my instructions from the first meeting.

The Court: This might be a good time to stop. Is that satisfactory?

Mr. Marcus: Yes, your Honor.

The Court: Make it 2:00 o'clock.

Mr. Bender: Yes.

The Court: And if you can, maybe we will tell Mr. Bowler that we will check with him at 3:00 o'clock.

(Noon recess.) [49]

Tuesday, July 17, 1956—2:00 P.M.

JOSE RAMIREZ

called as a witness on behalf of the plaintiff, having been previously sworn, resumed the stand and testified further as follows:

The Court: It looks like you have the exhibit there; is that correct?

Mr. Bender: That is correct, your Honor.

The Court: All right.

Cross-Examination

(Continued)

By Mr. Marcus:

Q. Mr. Ramirez, when is the first time you ever saw Mr. Lozoya in your lifetime?

A. As a fact, sir?

Q. Yes, sir.

(Testimony of Jose Ramirez.)

A. As a fact, on May 17th.

Q. When? A. On May 17th.

Q. When is the first time you ever talked to Mr. Lozoya? A. On May 17th.

Q. And at no time prior to May 17th had you ever talked to or seen or had any business dealings or conversation with Mr. Lozoya; is that true? [50]

Mr. Bender: The Government objects to the question on the ground that it is compound; it covers four different subjects, your Honor.

Mr. Marcus: I have already asked him two of them and he has answered.

The Court: I will overrule the objection. I overruled the objection he made to your question as being compound.

The Witness: On or about October 2nd I saw a person who resembled Mr. Lozoya.

Q. (By Mr. Marcus): But you are not sure he is the same person? A. That is true.

Q. So, so far as your memory now serves you, May 17th is the first day that you have a definite recollection of having seen or talked to or ever had any dealings or relations with Mr. Lozoya?

A. That is true.

Q. Is that correct? A. That is right.

Q. Directing your attention to May 17th again, you say you saw Mr. Villas that day?

A. Yes, sir.

Q. And you talked to him that day?

A. Yes, sir.

(Testimony of Jose Ramirez.)

Q. Did you tell Mr. Villas at that time to meet you at [51] the Beverly Market?

A. In substance, yes.

Q. Well, is it any different than I suggested to you?

A. Well, it was during the course of the conversation that we established the point of meeting at the Beverly Ranch Market.

Q. The Beverly Ranch Market on East Beverly Boulevard, in Montebello?

A. Yes, sir; Beverly and Poplar Streets.

Q. Yes, sir. At that time had he told you that he had talked to Mr. Lozoya?

A. Yes, sir.

Q. At that time did he tell you the substance of any conversation that he had with Lozoya?

A. Yes, sir.

Q. At that time did you tell him to meet you at that market?

A. Yes, sir.

Q. At that time did you tell him what kind of car you would have there?

A. I think he had prior knowledge of my automobile.

Q. My question was, did you tell him that day what kind of car you were going to drive?

A. I believe I did, yes.

Q. "I believe I did"—does that mean that you did? [52]

A. Yes, I believe so.

Q. Well, are you sure?

A. I don't recall the exact statement that I used to Johnny Villas, but I believe I said that I would be in a black Mercury.

(Testimony of Jose Ramirez.)

Q. What year Mercury is it? A. '53.

Q. Is that a convertible? A. Yes, sir.

Q. A '53 convertible, black in color, wasn't it?

A. Yes.

Q. What time did you arrive there that evening?

A. 7:00 p.m.

Q. What day of the week was it?

A. I do not recall, sir.

Q. Was that market open at that time?

A. Was it open?

Q. Yes. A. Yes, sir.

Q. I want you to describe the area immediately adjacent to where you parked, to the Judge. First, I will ask you if there is a house immediately next to the place where you were parked?

A. There is a long row of houses which resemble a tourist court. I don't know if it is a tourist court or [53] whether they are residences, but it is a long row. That is directly behind the automobiles where we were parked.

Q. Isn't it a fact, Mr. Ramirez, that immediately adjacent within a distance of two or three feet there was an inhabited dwelling where your car was parked?

A. Adjacent to the rear or to the side?

Q. Any place? A. To the rear, yes.

Q. And it was within two or three feet?

A. No, sir.

Q. How far?

A. I would say eight to ten feet.

Q. Well, weren't you a distance of two or three

(Testimony of Jose Ramirez.)

feet during your conversation with Mr. Lozoya of that house? A. I was not.

Q. Did you see any people that were coming out of that house?

A. During the time I was talking to Mr. Villas?

Q. Any time? Did you see any people come out of that house when you were there?

A. Yes, I did.

Q. Did you see some of the people who were seated in this court go there?

A. No, I did not.

Q. Could you identify the people today that you saw [54] coming out of that house?

A. No, I could not, because I didn't pay any attention.

Q. Do you remember somebody coming up to you during the time that you were talking there to Lozoya and telling you to quit using vile and abusive language in the presence of the children that were there? A. No, I do not recall that.

Q. Do you deny that somebody did come up there and ask you to refrain from using vile and abusive language in the presence of children that were there?

A. I do not recall anyone coming up there.

Q. Is it a fact, sir, that these other officers drove in on that lot in an automobile?

Mr. Bender: Counsel for the Government objects to the question on the ground that it has not been shown—you haven't established the time when, here.

(Testimony of Jose Ramirez.)

Mr. Marcus: I will come to that.

The Court: Withdraw the question and give the time.

Mr. Marcus: I'll do that, your Honor.

Q. (By Mr. Marcus): Well, you testified that just within a matter of minutes some officers came on the lot; is that right?

A. I testified, yes, sir, in a matter of minutes after defendant Lozoya had backed the car adjacent to mine.

Q. You testified that the whole transaction consumed [55] about five minutes; do you remember that? A. Yes, sir, I believe so.

Q. You testified, did you not, sir, that some officers came on the lot?

A. Yes, sir, some officers walked toward us.

Q. How did they get onto that lot?

A. Agent Gullen and Agent Freeman walked, and I believe—I'm not positive—Agent Miller and the rest came in an automobile.

Q. Is it a fact that four officers drove——

A. I——

Q. ——onto that lot in an automobile?

A. No, sir, not four.

Q. How many were in the car that drove onto that lot? A. I do not know.

Q. Well, you testified you saw the officers across the street? A. I did.

Q. How long before this incident took place did you see the officers across the street?

(Testimony of Jose Ramirez.)

A. I saw them between the period of 7:00 to the time of the transaction.

Q. Well, were they in an automobile?

A. No, they weren't.

Q. Wait a minute. At the time you saw them across the [56] street?

A. No, sir; they were on the street.

Q. Walking around?

A. Yes, sir. I believe that the ones across the street had the trunk of the government vehicle open.

Q. Please, I don't want you to guess on these things. You say you believe. If you are sure of it and you can testify under oath that that is what happened, tell us. If you are guessing, just tell us so. Are you sure that the trunk was open?

A. Yes, sir.

Q. Did you see it open? A. Yes.

Q. What do you mean before when you said you guess? A. I don't believe I guessed.

Q. Or you believed that the trunk was open? Was there some doubt in your mind a few minutes ago?

A. No, I think that is just a manner of speaking.

Q. Did these officers, to your knowledge, drive onto the lot in an automobile?

A. Which officers?

Q. The four officers that were across the street?

A. I don't believe there were four officers across the street.

Q. Well, if there was two or one officer, did any

(Testimony of Jose Ramirez.)

one [57] of the officers drive upon the lot in an automobile?

A. No, I did not see them walk across the street.

Q. Did you get into an automobile after this transaction? A. I did.

Q. Was the automobile you got into on that lot?

A. Yes, sir.

Q. Did you see the automobile get on the lot?

A. It was my automobile, the one that I had driven, on the lot.

Q. You got into your car? A. Yes, sir.

Q. Did you see what car the defendant Lozoya got into?

A. Yes, sir.

Q. Which one? A. A Buick.

Q. Whose car was that Buick?

A. I do not know which Agent it is assigned to. I believe it is Agent Miller's.

Q. Did you see how that car got onto the lot.

A. I imagine it was driven on.

Q. I don't want you to imagine.

A. I didn't see it driven on, no.

Q. Isn't that the car the agents drove onto that lot?

Mr. Bender: The witness has already testified that he [58] didn't see it driven on. How can he answer that?

Mr. Marcus: I am not bound by his answer. I have a right to cross-examine him to show he is mistaken, that he saw the car drive on there, because he got into it or at least the defendant got into it.

(Testimony of Jose Ramirez.)

The Witness: I did not see the car driven into the lot.

Q. (By Mr. Marcus): When did you see the car the first time?

A. When it was in front of my car immediately after the transaction.

Q. All of a sudden it appeared in front of your car? A. Yes.

Q. You never saw how it got on there, when it got on there? A. No, sir.

Q. When did you first notice that car appear in front of your car?

A. Well, when this transaction took place—after the transaction took place.

Q. Mr. Ramirez, isn't it a fact that the officers, the other officers drove that car onto that lot?

A. Well, someone must have driven it, because it can't operate by itself.

Q. I know. Well, you saw these officers come with drawn guns toward you, didn't you? [59]

A. I saw Agent Gullen, yes.

Q. Didn't you see the other officers come with drawn guns toward you? A. I did not.

Q. When did you see the other officers for the first time?

A. Well, after Agent Gullen and Agent Freeman had arrived, a matter of a minute or two.

Q. You saw Mr. Lozoya and Mr. Villas drive up in Mr. Lozoya's car, didn't you?

A. Yes, sir.

Q. Were you outside of your car at that time?

(Testimony of Jose Ramirez.)

A. No, sir; I was sitting in the car.

Q. Were you eating a banana at that time?

A. Yes, sir.

Q. And you continued to eat that banana during the entire conversation?

A. Up until I dropped it.

Q. I understand. During the entire conversation, I said? A. Yes, sir.

Q. What was the first words that were said, as you remember, when Johnny Villas walked up to you? What was said first?

A. He says—he says, “I don’t know if he brought the [60] stuff with him or not.”

Q. He said that? A. Yes.

Q. What did you say then?

A. I didn’t say anything. I just went up to talk to the defendant Lozoya.

Q. Was Lozoya there at that time?

A. Lozoya was seated in the car.

Q. Villas got out of the car and walked up to you? A. Yes.

Q. And said, “I don’t know if he brought any stuff or brought the stuff with him”? A. Yes.

Q. So then you walked over to where Mr. Lozoya was sitting in his car? A. Yes.

Q. You had never met the man before?

A. No, sir.

Q. You didn’t know him from Adam, did you?

A. Yes, sir.

Q. Oh, you did? Well, you hadn’t been introduced to him? A. No, sir.

(Testimony of Jose Ramirez.)

Q. You had no conversations with him on any previous occasion? [61] A. No, sir.

Q. And you walked up to his car alone, without any introduction? That is what I am to understand? Yes, or no?

A. Yes, I walked up there and spoke to him.

Q. Did you tell him your name?

A. No, sir.

Q. Did you tell him where you were from?

A. No, sir.

Q. Did you have conversation in the English language or Spanish language?

A. I believe that it was mixed English and Spanish. Predominantly it was in Spanish.

Q. When you say "I believe," does that mean you are not sure? A. I am not sure.

Q. At least, you began conversing with him?

A. Yes.

Q. What is the first words that were said by any of you two at that time?

Withdraw that.

Who spoke first?

A. I believe Johnny Villas.

Q. You believe? Is that—

A. Well, I didn't keep a record of who spoke first, but to the best of my recollection Johnny Villas spoke first. [62]

Q. What did he say, to your best recollection? What were the first words he said?

A. To my best recollection, he said, "Cuckoo, this is my friend here."

(Testimony of Jose Ramirez.)

Q. I didn't get that.

The Court: "Cuckoo."

Mr. Bender: "Cuckoo, this is my friend here."

Q. (By Mr. Marcus): Well, who was he directing his remarks to? A. Defendant Lozoya.

Q. Said to whom?

A. Johnny Villas said to defendant Lozoya, "Cuckoo, this is my friend here."

Q. Did he give him your name?

A. No, I don't think he did.

Q. Well, when you say again you don't think so, do you mean that he didn't or you don't remember? A. It means that I don't recollect.

Q. Please, Mr. Ramirez, if you don't remember, say so. You don't remember whether any names were given? A. That is right.

Q. Did Mr. Villas at that time tell you Mr. Lozoya's name?

A. No; he just said "Cuckoo."

Q. Then who spoke next? [63]

A. I did. I said, "Orali." You know, that is just like "Hi" in Spanish.

Q. Then what transpired after that?

A. I asked him if he had something for me, and he said "Yes."

Q. Did he ever mention at that time what it was?

A. Yes, sir.

Q. Well, was that part of the conversation?

A. Yes, sir.

Q. Well, as I understand, you asked him, "Have you got anything for me"?

(Testimony of Jose Ramirez.)

A. "Do you have anything for me?"

Q. "Do you have anything for me?"

A. Yes.

Q. And he said "Yes"? A. Yes.

Q. And then what did you say?

A. I said, "How much do you have?"

Q. Nothing else said before that at all?

A. No, sir.

Q. And what did he say when you said "How much"? A. He said "Ten pounds."

Q. "Ten pounds?" Now, Mr. Ramirez, isn't it a fact that Mr. Villas walked up to that car and said, "This is Mr. Lozoya, who I talked to you about, who owns that restaurant"? [64] A. No, sir.

Q. You knew that he owned the restaurant at that time, didn't you?

A. I knew he was connected with the restaurant. I didn't know whether he was the proprietor or just the manager.

Q. Was anything at that time stated about a restaurant? A. No, sir.

Q. Isn't it a fact that you said to Mr. Lozoya that your name was M. Ramirez? A. No, sir.

Q. Didn't he tell you that you were driving a beautiful car? A. I don't recall.

Q. Isn't it a fact that at that time you said to him, "Are you interested in doing business with me"? A. No, sir.

Q. Isn't it a fact, sir, at that time he asked you if you were interested in buying his restaurant?

(Testimony of Jose Ramirez.)

A. No, sir.

Q. Nothing said about a restaurant?

A. No, sir.

Q. What did Villas say at that time?

A. At what time?

Q. At that time during that very portion of the conversation? [65]

A. As I recall, Villas didn't say anything except the introduction.

Q. Well, your purpose, sir, at that time was to buy some marijuana, wasn't it? A. Yes, sir.

Q. And you were using Villas to help you?

A. Yes, sir.

Q. You didn't know what Villas had told Mr. Lozoya before on the way over there, did you?

A. No.

Q. Didn't you and Mr. Villas talk together alone in your car before you walked over to Lozoya's car?

A. Just the conversation that I have given here, that he said, "I don't know if he has got the stuff or not."

Q. I am asking you if you didn't talk together alone? A. Just that conversation.

Q. I didn't ask you how much. A. Yes.

Q. I just asked you if you didn't talk alone?

A. Yes.

Q. Then you proceeded to the car of Mr. Lozoya?

A. Yes.

Q. There were a lot of cars parked on that lot, weren't there?

(Testimony of Jose Ramirez.)

A. There were a few, yes. [66]

Q. What do you mean by a few?

A. By a few I would say in the area of eight cars.

Q. Right in the same vicinity that your car was parked; is that right?

A. Well, two different vicinities, if we are to divide the lot into areas.

Q. The market was open, people were walking in and out of that market weren't they?

A. Yes, sir.

Q. Did you tell him that you wanted to buy some marijuana?

A. I didn't use those exact words, no.

Q. Well, was that the language, in substance, that you used to Mr. Lozoya? A. Yes.

Q. That you wanted to buy some marijuana?

A. Yes.

Q. Didn't he say to you, "What makes you think I have marijuana to sell"? A. No.

Q. Well, did you begin talking about the marijuana? A. Yes, sir.

Q. Didn't you tell him at that time that you had a pocketful of money? A. No, sir. [67]

Q. Did you tell him you had enough money to buy marijuana? A. No, sir.

Q. Didn't you take out the money, a roll of bills, and say, "Here is the money I have to buy marijuana with"? A. No, sir.

Q. Didn't show him the money? A. No, sir.

Q. Didn't you take out the money at any time?

(Testimony of Jose Ramirez.)

A. Toward the end of the transaction, yes.

Q. Well, this whole business only took five minutes? A. That is true.

Q. Didn't you take your money out of your pocket?

A. Toward the end of the transaction, yes.

Q. I didn't ask you that, I just want to know if you didn't take the money out of your pocket?

A. During that period, yes.

Q. Yes, and you showed it to Mr. Lozoya, didn't you? A. Yes.

Q. Didn't you tell him, "I have plenty of money to buy all the marijuana I want"?

A. No, sir.

Q. Did you tell him how much money you had?

A. No.

Q. Didn't you tell him you had enough to buy ten [68] pounds with? A. No.

Q. Well, you know how much ten pounds cost, according to what you stated in the conversation?

A. Yes.

Q. How much was it?

A. \$60 a pound, or \$600.

Q. That would be \$600, wouldn't it?

A. Yes, that is true.

Q. Did you have the \$600 on you? A. Yes.

Q. And you took that \$600 out of your pocket?

A. Yes.

Q. And you showed it to him, didn't you?

A. Yes.

(Testimony of Jose Ramirez.)

Q. Where did you have that money that you took out of your pocket? What pocket was it in?

A. In my left front pocket.

Q. Was it wrapped up?

A. It was just folded.

Q. What was the denominations of it?

A. It was mixed denominations, twenties, tens and fives.

Q. Do I understand, sir, you to testify under oath that this man went to his car, parked there in the open, opened the back of the trunk, took out some substance there [69] in a gunny sack, and put it into your car?

A. Yes, sir.

Q. And you hadn't paid him a dime of money?

A. That is true.

Q. How old are you, by the way?

A. 29.

Q. You have been a narcotics officer, a regular narcotics officer for about a year and a half or two years?

A. It will be two years on August 8th.

Q. This was a deal involving, as you claim, \$600?

A. Yes.

Q. You had never seen this man before and he took out \$600 worth of marijuana and put it into your car before you gave him or intended to give him a dime?

A. That's right.

Q. And you never gave him a dime?

A. That is right.

Q. Isn't it a fact, sir, when these other officers walked up to that car, they asked you, "Where is the stuff"?

A. No, sir; they didn't ask me that.

(Testimony of Jose Ramirez.)

Q. And isn't it a fact that you said, "It's in my car"? A. No, sir; I don't recall.

Q. Nothing like that said at all?

A. No, sir.

Q. In substance or effect? [70]

A. No, sir.

Q. And didn't you say, "I opened"—then they went to the car, opened the trunk of your car and took the stuff out of your car? Did that happen?

A. Yes, sir.

Q. And they asked you, "What's this stuff"—the other officers? A. Asked me——

Q. Asked you that question?

A. I don't recall that question being asked.

Q. You don't deny it, do you?

A. I don't recall it.

Q. You don't remember that? And isn't it a fact, sir, that you said at the time, "I don't know. This car is registered to my girl's name"? Do you remember making that statement? A. Yes, sir.

Q. And "You will have to ask her how that stuff got into the car"; do you remember making that statement? A. Not the latter statement, no.

Q. Did you say, "You would have to find out from her how it got into the car, because it was registered to her name"?

(A pause.)

Q. Why do you hesitate on these answers? [71]

A. I am trying to remember the conversation as it occurred.

(Testimony of Jose Ramirez.)

Q. Well, you stated already that you had conversation with them, in which you said the car belonged to your girl friend?

A. Yes, I remember that conversation.

Q. Didn't they ask you who the girl friend was?

A. No, sir.

Q. Did you tell them that the car was registered in your girl friend's name? A. Yes.

Q. Didn't you tell them, in that same conversation, that they would have to find out from the girl, because you just borrowed the car?

A. I recall saying that I borrowed the car from her.

Q. How did you happen to say that you borrowed the car from your girl friend? Wasn't it in connection with how that package got into the back of your car?

A. This conversation was for the purpose of defendant Lozoya as I was arrested.

Q. I didn't ask you for the purpose. I want to know what was said. I know what your purpose was.

The Court: He just wants the conversation.

Mr. Marcus: That's all I want.

The Witness: O.K. [72]

Q. (By Mr. Marcus): Try to remember this part, will you? A. Yes.

Q. You didn't tell Mr. Lozoya that you were an officer? A. No, sir.

Q. You didn't tell him that Mr. Villas was a special narcotic officer, did you? A. No, sir.

(Testimony of Jose Ramirez.)

Q. Or that he, Villas, was employed by the Federal Government either, did you? A. No, sir.

Q. This Villas, now, was never employed by the Federal Government, was he?

A. He was assisting our Bureau, yes.

Q. I didn't ask you that question. He was never employed by the Federal Government, was he?

A. He was employed to assist us in this investigation.

Q. That means that you hired a stool pigeon; is that it?

Mr. Bender: That is objected to as asking for a conclusion, your Honor.

Mr. Marcus: I'll withdraw it.

The Court: All right.

Q. (By Mr. Marcus): Does his name appear of record in your department as an employee of the Federal Government?

A. The records in Washington, D. C.?

Q. Here in your Department here? [73]

A. I do not know whether there has been any written letters to that effect, no.

Q. Mr. Ramirez, you know very well that he is not an employee and never has been an employee, nor does his name appear of record as being an employee of the Federal Government; isn't that a fact? A. Has never appeared——

Q. As an employee of the Federal Government in the Narcotic Division?

A. In what capacity?

(Testimony of Jose Ramirez.)

Q. I didn't say anything about capacity at all. As an employee of the Federal Government in the Narcotics Division?

A. He was employed to assist us in this investigation, Yes.

Q. Does his name appear of record in any records or documents as an employee of the Federal Government?

A. As I said before, I do not know if there is any written testimony to this effect.

Q. I didn't want any written testimony. I want to know whether or not his name appears in any record? A. I do not know.

Q. Of the Federal Government. I want to subpoena that record. A. I do not know.

Q. As a matter of fact, you do know that his name does [74] not appear as a Federal employee, don't you? A. I do not know.

Q. Who was it—what officer was it that asked you who that car belonged to? A. What car?

Q. That is the car you were driving?

A. I do not recall.

Q. Well, it would have to have been one of the four, wouldn't it? A. That is true.

Q. And you remember that conversation?

A. Yes, sir.

Q. And you don't know who said it?

A. That is right.

Q. Did you make a record of the conversations that were had there?

A. Only with the defendant Lozoya.

(Testimony of Jose Ramirez.)

Q. Did you make a record of the conversations that were held there? A. Yes.

Q. Where is that record?

A. Upstairs in the office.

Q. Did you refresh your memory from that record before you testified today? A. I did. [75]

Q. Did you bring the record down to court with you? A. No, sir.

Q. Is there anything in that written record that says that one of the officers asked you who that black '53 convertible belonged to? A. No, sir.

Q. You left that out? A. Yes, sir.

Q. Is there anything in that written record that says that you told that officer that the car belongs to my girl friend? A. No, sir.

Q. Did you leave that out of that written record?

A. Yes, sir.

Q. Is there anything in that written record that says that Mr. Lozoya told you that he had brought the stuff? A. Yes, sir.

The Court: You say brought the stuff?

Mr. Marcus: Brought the stuff.

The Witness: Yes, sir.

Q. (By Mr. Marcus): Is that the words that he used? A. No, sir.

Q. Well then, tell us what words he used?

A. I asked him if he had something for me, and he said "Yes." [76]

Q. Is that all that was used in connection with marijuana? A. No, sir.

(Testimony of Jose Ramirez.)

Q. Well, what else did he say in connection with it?

A. I asked him how much he had, and he said "Ten pounds." Then I asked him how much it would cost, and he said "\$60 a pound." I asked him if the marijuana was good——

Q. Did you use the word "marijuana"?

A. Yes, only in Spanish.

Q. Beg your pardon. A. Only in Spanish.

Q. Tell me the difference between English and Spanish in marijuana. Aren't the words the same?

A. No.

Q. What is the word for "marijuana" in Spanish?

A. There are various words used on the street.

Q. You said you used "marijuana" in Spanish. What is the word for "marijuana" in Spanish?

A. Marijuana.

Q. So it is the same thing? A. Yes.

Q. What do you mean, it was not the same word in Spanish?

A. Because I didn't use the term "marijuana." I used "llesca." [77]

Q. What did he use?

A. All he said was "Yes."

Q. Then you didn't use the word "marijuana"?

A. I used the word "llesca."

Q. Is that marijuana? A. Yes, it is.

Q. "Llesca" is marijuana? A. Yes.

Q. You know I speak Spanish, don't you, Mr. Ramirez? A. Yes.

(Testimony of Jose Ramirez.)

Q. "Llesca" means marijuana? A. Yes.

Q. In what language?

A. In the language used by the people on the street.

Q. That all depends on what street you are on, doesn't it? A. That is true.

Q. That is a slang expression?

A. Yes, it is.

Q. And to you that meant "marijuana"?

A. Yes.

Q. But the true word in Spanish is marijuana, isn't it? A. Yes.

Q. And that is the same way you pronounce it in English, isn't it? [78] A. Yes.

Q. Now, when this boy Lozoya arrived there, did you observe his features?

A. I saw him, yes. I saw him driving the car.

Q. My question was, did you observe his features? A. Yes.

Q. You saw his face? A. Yes.

Q. Did he have a black eye at that time?

A. I didn't notice whether he did or not.

Q. Well, if you observed his features, you could tell whether a man had a black eye or not, if you talked to him five minutes, as you claim you did, couldn't you?

Mr. Bender: That is objected to as being argumentative, your Honor.

Mr. Marcus: It is. I withdraw it.

The Court: The question is withdrawn.

(Testimony of Jose Ramirez.)

Q. (By Mr. Marcus): You say you looked at the man, you talked to him? A. Yes.

Q. You didn't observe whether or not he had a black eye?

A. I didn't notice a black eye.

Q. At least you didn't see any?

A. That's right. [79]

Q. Did you see any marks or bruises or contusions about his head or his face at that time?

A. No, I did not.

Q. Mr. Ramirez, when one of these other officers, whose name you do not now remember, opened the back trunk of your car and took out this marijuana, took out this package——

Mr. Bender: The Government is going to object to the question on the ground that he states he does not remember. There is no testimony by this witness. He didn't remember the name. He didn't know who did it.

The Court: Well, let him finish.

Mr. Bender: I'm sorry. He paused. I thought he was waiting for me to make an objection.

The Court: Start all over.

Q. (By Mr. Marcus): This officer who opened the trunk of your car, do you remember his name?

A. No, sir.

Q. Do you remember what officer said to you that this stuff, how did it get into the car, and you said it was your girl friend—do you remember who said that? A. No, sir.

Q. Is that the same officer who opened the trunk

(Testimony of Jose Ramirez.)

of the car? A. I do not recall.

Q. Well, this was rather important at the time, wasn't [80] it? A. What? That conversation?

Q. This transaction was rather important at the time? A. That conversation you just repeated?

Q. Yes. A. Yes, it was.

Q. Then you don't remember it now?

A. That is true.

Q. Well, did this officer say to you at the time, "You're coming along with us"? A. Yes.

Q. Did he say that you were under arrest, too?

A. Yes, sir.

Q. They didn't put any handcuffs on you, did they? A. No, sir.

Q. They put the handcuffs on Mr. Lozoya, didn't they? A. Yes, sir.

Q. What did he say when they were putting the handcuffs on him?

A. I do not recall his conversation, but he said that he had stopped in the store to buy some groceries. I believe that is what he said.

Q. Do you have that in your written report?

A. No, sir.

Q. You are just guessing about that conversation. [81] aren't you?

A. It is to my recollection, yes.

Q. Isn't it a fact that he said at the time, "I didn't take any marijuana out of that car and put it in any other car"? A. Yes.

Q. Didn't he say that?

A. Not in those words.

(Testimony of Jose Ramirez.)

Q. In substance and effect?

A. In substance, he said he had not placed that sack in my car.

Q. And didn't he say he knew nothing about any marijuana?

A. I believe he said, "I don't know anything about it. I don't recall the word "marijuana."

Q. What did you say at the time he didn't know anything about it? A. Nothing.

Q. You didn't say he put that stuff in your car, did you? A. No, sir.

Q. You didn't say Villas had brought him over there for the purpose of delivering marijuana to you? A. No, sir.

Q. You hadn't given him any money at that time, either, [82] had you? A. No, sir.

Q. You have access to marijuana, haven't you?

A. No, sir.

Q. Well, you had access to this marijuana, didn't you? A. Yes.

Q. How many times have you made arrests for marijuana in the past?

(A pause.)

The Court: Just approximately?

The Witness: I don't recall. Approximately two times, I believe—once or twice.

Q. (By Mr. Marcus): You mean to say you can't remember how many arrests you made, if it is only two in the past year? A. That's right.

Q. Well, whom did you arrest the first time?

(Testimony of Jose Ramirez.)

A. I don't recall.

Q. In the past year?

A. In the past year, I do not recall whom I have arrested.

Q. Who was the second arrest you made?

A. I don't recall.

Q. You don't even remember who the two were?

A. Of marijuana arrests? [83]

Q. That's what I'm talking about.

A. Lozoya.

Q. I'm not talking about that. I'm talking about other arrests you made before this occasion.

A. I don't recall whom I have arrested prior to this occasion.

Q. You have been on this force for two years?

A. Yes, sir.

Q. And you don't know whom you arrested in the past year?

A. That's right.

Q. And there were only two?

A. That is right.

Mr. Bender: There has been no testimony that there were only two.

Mr. Marcus: He said he thinks there was two arrests.

Am I mistaken?

Mr. Bender: He said about two—that is, for marijuana, he said.

Mr. Marcus: Yes, that's exactly what I said, for marijuana.

The Court: Yes.

Q. (By Mr. Marcus): Now listen, wasn't it Mr.

(Testimony of Jose Ramirez.)

Villas one of the arrests that were involved in this case? I'll try to remind you. [84] A. No, sir.

Q. That was not a marijuana case?

A. Yes, it was.

Q. You were involved in that arrest, weren't you? A. Yes.

Q. That was one of them, wasn't it?

A. If you will recall, that was prior to this year.

Q. I said within the past year.

A. It was before the first of this year.

Q. I didn't say before the first of this year. I said the prior year.

A. To this transaction?

Q. Yes. A. Yes, it was.

Q. So we have one now? A. Yes.

Q. Moreno was the second one, wasn't he?

A. That's right.

Q. Is that right? A. That is right.

Q. I happened to be interested in both those cases, do you remember? A. Yes.

Q. Did you make any other arrests for marijuana during that period of time? [85] A. Yes, sir.

Q. Tell me who they were.

A. Rommels and Rojas.

Q. That was that same case? A. Yes.

Q. That was only one arrest, but four defendants involved; isn't that right? A. Yes.

Q. Did you make any other arrests besides in that case? A. No, sir; I don't believe so.

(Testimony of Jose Ramirez.)

Q. You don't believe so?

A. I can't testify without checking my records.

Q. I am testing your memory right now. You are testifying to conversations that were had five months ago, and you don't know whom you arrested in the past year when there were only two. Did this defendant here, Mr. Lozoya, ever tell you that this marijuana was his? A. Yes.

Q. When?

A. When he said, "There is no complaint about my stuff."

Q. That was when?

A. During this conversation.

Q. Did he tell you that this marijuana was his?

A. He said "my stuff."

Q. "There's no complaint about my stuff"? [86]

A. That is right.

Q. I am talking about this marijuana here. Did he tell you anything about this marijuana?

A. He said "my stuff."

Q. Mr. Ramirez, you say you looked at it?

A. Yes.

Q. This all happened in a period of a few minutes; is that right? A. Yes.

Q. In the meantime, before you got a chance to deliver any money, your friends, your fellow officers came with drawn guns? A. Yes, sir.

Q. At that time didn't you tell your friends that that stuff must have belonged to your girl friend, you didn't even know what it was?

A. I don't recall that conversation.

(Testimony of Jose Ramirez.)

Q. What were you hiding about then, because this defendant was under arrest, wasn't he?

A. Yes, sir.

Q. You had no reason at that time to hide your identity, did you? A. I did.

Q. Well, if he was under arrest and you had the marijuana, there was certainly no reason to hide your identity, [87] was there?

A. Yes, there was.

Q. Because he admitted to you, isn't it a fact, that the marijuana belonged to him, or that he had transferred it from one car to another?

A. No, sir.

Q. Isn't that the reason? A. No, sir.

Q. And you wanted to go along to the station to see if you could get further information from him?

A. No, sir.

Q. When you got to the station, he told you to shut up, didn't he? A. Sir?

Q. You began talking to him and he said, "You shut up"?

A. Yes. No, sir; he didn't say to "shut up"; he just motioned with a finger.

Q. Motioned with his finger? Did he say "Shush"? A. Yes.

Q. Did he say "Shut up"? A. No.

Q. He told you he didn't want to talk to you, too, didn't he?

A. No, sir; I don't believe he said that.

Q. Didn't he tell you—by the way, was Villas in [88] there, too, with you? A. No, sir.

(Testimony of Jose Ramirez.)

Q. Wasn't even along with you?

A. He was not in the interrogation room.

Q. Did Villas drive with you to the Federal Building here?

A. Yes. Not in my car; in another car.

Q. I don't care how he got here. Did he drive to the Federal Building?

A. No; he was conveyed.

Q. He was conveyed in an automobile?

A. Yes.

Q. And you saw him in the building?

A. Yes.

Q. And you talked to him here in the building?

A. Yes.

Q. Didn't you have a conversation with the other officers in this building about how you were going to get this Lozoya to talk? A. Yes.

Q. And at that time didn't you say, "We will pound it out of him"? A. No, I did not.

Q. Did you see him with a black eye when you got over to the county jail on May 24th? [89]

A. Yes, I believe he had a discoloration of the eye.

Q. Yes, and you saw that his head was bandaged, too, didn't you? A. I do not recall.

Q. Now listen, Mr. Ramirez, isn't it a fact that he was beat up right in this building here?

A. I do not know that.

Q. You were there in the period of the interrogation, weren't you?

A. Not in the same room, no.

Q. I didn't say in the same room. You were there

(Testimony of Jose Ramirez.)

in the Narcotics Bureau offices during this interrogation? A. Yes.

Q. And you saw the other officers go into that room, didn't you? A. Yes, I did.

Q. And you heard screaming in that room, didn't you? A. I did not.

Q. Did you see him come out with his eyes swollen? A. No, I did not.

Q. Did you examine his booking slip when he was booked at the county jail?

A. No, I did not book him.

Q. Did you talk to the other officers as to what was going to happen to the defendant Lozoya if he didn't admit [90] it was his stuff? A. No, sir.

Q. No, no question about it. Did they tell you they were going to pound it out of him?

A. No, they did not.

Q. As I understand, sir, you didn't see anybody strike this man? A. I did not.

Q. There is as much truth to that statement, is there, as there is to the other testimony you have given? A. That is true.

Q. You didn't see him with a black eye when you talked to him out there on the lot?

A. That is true.

Q. Did you see him with his eye swollen when he was in the interrogation room?

A. No, I did not.

Q. Did you see him with a black eye after he was booked at the county jail?

A. No, I did not.

Q. Did you see his eyes discolored?

(Testimony of Jose Ramirez.)

A. On the 24th?

Q. On the 24th. A. Yes.

The Court: I think maybe I'll have you get back to the [91] lectern.

Mr. Marcus: I just wanted to show him this.

The Court: All right.

Q. (By Mr. Marcus): What day was he booked, to your knowledge?

A. That same evening, the 17th.

Mr. Bender: Counsel, would you let me see that, please.

Mr. Marcus: Excuse me (showing document to Mr. Bender).

Q. (By Mr. Marcus): Did Mr. Lozoya at any time admit to you or to anyone else in your presence that he had anything to do with that marijuana?

A. No, he did not.

Mr. Bender: Do you intend to have it marked for identification?

Mr. Marcus: Yes. May the booking slip be marked for identification at this time as defendant's exhibit?

The Court: Yes, Defendant's Exhibit A.

(The document referred to was marked Defendant's Exhibit A for identification.)

(Testimony of Jose Ramirez.)

DEFENDANT'S EXHIBIT B

Name: Lozoya, Refugio G.

No. 424165

Tank No. 11A2.

Property Slip

Date: 5-17-56.

Charge: vio fed narc laws.

Cash Deposited to Account: \$30.00.

Rec. No. 215046.

Cash Ret'd. to Prisoner: \$2.92.

Property: black billfold & papers, pr. dark glasses,
ym wrist watch, 1 key.

Recent Injury or Illness: claims black eye, bruises
on right leg.

Booked by: R. Dism.

Searched by: Olson.

I hereby Authorize the Sheriff or Jailer to Re-
ceive and Open All My Mail While I Am Confined
to the Los Angeles County Jail.

Signature (Not an Acknowledgment of Guilt.)

/s/ REFUGIO G. LOZOYA.

X-Ray Minifilm No. 95534. Made at Time of Book-
ing.

Identified July 17, 1956.

(Testimony of Jose Ramirez.)

Q. (By Mr. Marcus): Is it not a fact, Mr. Ramirez, that he told you that they had busted his eardrum? A. No, sir.

Q. Were you there until he was taken out of this building for booking?

A. Yes, I was in the offices, yes. [92]

Q. Did you go along at the time he was booked?

A. No, sir.

Q. But you were here when he left?

A. Yes, sir.

Q. Did you talk to him at the time he was leaving? A. No, sir.

Q. Did you see anybody kick him in his legs?

A. No, I did not.

Q. Stomp him?

A. I didn't see him when he left.

Q. At least, at no time, as a result of anything that happened there, did he ever admit that he had anything to do with any marijuana; is that correct?

A. He never admitted to me; no, sir.

Q. Or to anybody else in your presence?

A. Not in my presence, no.

Q. Where do you take the marijuana to impound it after an arrest? A. After an arrest?

Q. Yes.

A. Mr. Chappell puts it in his safe.

Q. What do you do with it?

A. What do I personally do with it?

Q. Yes.

A. I get it and weigh it and seal it and give it to [93] Mr. Chappell.

Q. Is that what you did with this marijuana?

(Testimony of Jose Ramirez.)

A. No, sir.

Q. I am directing your attention to this package here.

A. I just weighed that and sealed it the following day.

Q. So this was in your possession until the following day?

A. No, it was in the safe. I gave it to Agent Chappell.

Q. It was in your possession until you brought it in and booked it and filed it in the safe, wasn't it?

A. Yes.

Q. So you have marijuana in your possession at least some time during the arrest and processing of the evidence?

A. Yes.

Q. And how long has that practice been going on?

A. Since I have become an agent.

Q. Do you then have access to this marijuana when you want it for any purpose?

A. Yes, I make a—

Q. Yes or no.

A. Yes.

Q. So that the marijuana that is booked and processed by you is available to you, no matter what amount; is that correct? [94]

A. Yes.

Mr. Marcus: Just a couple more questions, your Honor, please.

The Court: All right.

Q. (By Mr. Marcus): Were you with the other officers when they went over to the county jail?

A. No, sir.

(Testimony of Jose Ramirez.)

Q. Were you with the other officers when he was taken out of the Federal Building room?

A. No, sir.

Q. Did you hear any conversation between any other officer and the defendant Lozoya?

A. No, sir.

The Court: We can take a short recess now. If you think of any more questions, then you may ask them after the recess.

(Recess.)

Q. (By Mr. Marcus): Mr. Ramirez, did you take possession of the object that you say was in your car? A. Yes, I took possession.

Q. Did you take it with you to the Federal Building? A. Yes, sir.

Q. Did you dust that package at any time for prints? A. No, sir.

Q. You say you saw the defendant have his hands on it, [95] didn't you? A. Yes, sir.

Q. Do you have a crime laboratory?

A. No, sir; we don't.

Q. Do you know how to dust for prints?

A. Yes, sir.

Q. Do you have the paraphernalia to dust for prints? A. Yes, sir.

Q. And you are acquainted with fingerprint dusting? A. Yes, sir.

Q. And how to check fingerprints?

A. Yes, sir.

Q. Did you do it on this package that you had?

(Testimony of Jose Ramirez.)

A. No, sir.

Mr. Marcus: Just a couple of more questions now.

Q. Mr. Villas, you say, was present there at the time that the other officers came up?

A. Yes, sir.

Q. What was said, to your knowledge, by any of the other men to Villas?

A. To stand still, "You're all under arrest." That is in substance.

Q. Said that to Villas, too?

A. To the three of us.

Q. What did Villas say? [96]

A. I do not recall what he said.

Q. By the way, had Villas ever been with you in the presence of those other officers?

A. On one occasion.

Q. All of them? A. No, sir.

Q. How many? A. One.

Q. What was his name? A. Freeman.

Q. How long before?

A. That same day in the morning.

Q. Didn't Villas at that time say, "I have nothing to do with this"?

A. I do not recall his conversation.

Q. Now, didn't Mr. Freeman or one of the other officers say, "What do you know about this, Villas"?

A. I don't know, sir.

Q. I'm trying to refresh your memory. Do I understand, sir, that you don't remember that conversation with Villas either?

A. That's right.

(Testimony of Jose Ramirez.)

Q. Is that it?

A. That's right. I don't recall.

Q. I'll try to refresh your memory a little [97] bit. Isn't it a fact that one of the officers who came up said, "What is your name," addressing his remarks to Mr. Villas?

A. I don't recall that conversation.

Q. Isn't it a fact that at that time they said to him, "What do you know about this stuff in the car"? A. I do not recall that conversation.

Q. Isn't it a fact that one of the officers said, "Where is the stuff"?

A. No, I don't recall that conversation.

Q. Do you deny that that conversation took place, or you don't remember that that conversation took place?

A. I don't remember that conversation.

Q. Didn't you say at that time, "The stuff is in my car"? A. No. I know that——

Q. Well, the stuff was in your car, wasn't it?

A. Yes.

Q. Didn't one of the officers say, "Is there any stuff in the other car?"

A. No; I don't believe so.

Q. Didn't he search the other car?

A. I do not recall anyone searching that car?

Q. Didn't you look over the car that Mr. Lozoya came in? A. No, sir. [98]

Q. Didn't any of the other officers, in your presence, look over that car? A. No, sir.

(Testimony of Jose Ramirez.)

Q. Now, isn't it a fact, Mr. Ramirez, that you stood there while the other officers went to Lozoya's car and began searching it from top to bottom?

A. I may have been present. I was not aware they were searching.

Q. Well, you were present? A. Yes.

Q. There isn't any question about that, is there?

A. Yes, I was present.

Q. And didn't they go to the car and open up the trunk of Lozoya's car?

A. I do not recall them opening the trunk.

Q. Do you deny they went to the car?

A. I'm not denying it. I don't recall it.

Q. Isn't it peculiar, sir, that you remember some of these things——

Withdraw that.

Isn't it a fact that the other officers, one of them said to you, "We don't find anything in Mr. Lozoya's car, not even a leaf"?

A. No, they never said that.

Q. Well, was there a conversation at that time about [99] marijuana being in Mr. Lozoya's car?

A. No, sir.

Q. Didn't you tell them that it came out of Lozoya's car? A. I did not.

Q. Well, you told them afterward, didn't you?

A. Yes.

Q. You told them before that he was supposed to deliver it to you, didn't you? A. Yes, sir.

Q. So they knew at least from conversation with you that it was to be delivered? A. Yes.

(Testimony of Jose Ramirez.)

Q. Didn't they? A. Yes.

Q. And you say you don't remember whether they searched his car to find some evidence of the existence of marijuana in his car, to connect it up with this marijuana? A. That is true.

Q. Well now, you have been a Narcotics Agent for several years, you say? A. Yes, sir.

Q. And you have been a full-fledged Narcotics Agent for two years? A. Yes, sir. [100]

Q. Didn't it occur to you that at that time, or at least prior to that time, to search Lozoya's car to see if there was even a leaf in his car or a seed or something? A. No, it did not occur to me.

Q. It did not occur to you? A. No.

Q. Don't you think it would have been good detective work at least to have gone to that car and searched it? A. Yes.

Q. But you didn't?

A. If I had been an arresting officer, I would have.

Q. But you were the investigating officer, the contact officer, and you were the officer that was present that had the conversation. As you say, you are the officer that observed him take it from one car to another? A. Yes, sir.

Q. And you had discussed the matter with the other officers beforehand? A. Yes, sir.

Q. And nobody went to Lozoya's car to search it? A. I didn't say that, sir.

Q. I know you didn't say that. But you didn't see anybody go to his car? A. That is true.

(Testimony of Jose Ramirez.)

Q. What happened to his car now? [101]

A. That car remained at the parking lot.

Q. Wasn't that car impounded? A. No, sir.

Q. How many officers went to the station?

A. The station? There were three.

Q. How many remained there?

A. Would you please explain that?

Q. How many officers remained there?

A. Remained where, sir?

Q. Remained there on the lot after you departed for the station?

A. After I departed for the station?

Q. Yes.

A. What station?

Q. Your station here at the Federal Building?

A. Oh, the officers? No one remained there, to my knowledge.

Q. Did you or any other officer find as much as a seed or a leaf in Lozoya's automobile?

A. I did not search his car.

Q. I didn't ask you whether you searched his car. To your knowledge, did anybody find as much as a leaf or a seed in Lozoya's car? A. No.

Q. You say you opened it — you opened, the package, [102] didn't you? A. Yes.

Q. And you say that you examined it, didn't you? A. Yes, while it was in my car.

Q. While it was in your car? A. Yes.

Q. And it was in a gunny sack, wasn't it?

A. Yes.

(Testimony of Jose Ramirez.)

Q. You saw the lid of Lozoya's car open, you say? A. Yes.

Q. And you saw the marijuana come out of that car? A. Yes.

Q. Or whatever it was that was in there?

A. Yes.

Q. Is that right? A. That is right.

Q. And you never even searched Lozoya's car?

A. That is right.

Q. Never looked in it to find out whether there was one seed or one leaf or one twig there, did you?

A. That is right.

Q. You did search the car afterward, didn't you? A. No, I did not.

Q. And you found nothing in Lozoya's car, did you? A. I did not search it. [103]

Q. Any other officer say they searched the car?

A. No one told me they searched the car.

Q. They told you, didn't they, when they came up there, that they saw it taken from one car to another? A. Yes, they said they saw it.

Q. Was the lid of his car opened at the time?

A. It had to be to extract it.

Q. Well, was it? Did you see it open?

A. Yes, I saw it open. I testified that I did.

Q. Didn't you say to the other officers, "Search his car and find out if there is not any marijuana seed or leaves in there"? A. No, I did not.

Q. Villas went to the station, too, didn't he?

A. No, sir.

Q. He was never stopped at all?

(Testimony of Jose Ramirez.)

A. No, sir.

Q. Never detained at all? A. No, sir.

Q. To your knowledge, he went on home from there? A. No, sir.

Q. Where did he go?

A. He was brought to the office.

Q. That is what I say.

A. You say "station," sir, there was a station in the [104] area. I am confused what you mean by "station."

Q. I am talking about the Federal station. Did you have any state officers with you?

A. No, sir.

Q. These were all regular employees of the Narcotics Division? A. There were five Agents.

Q. Were they all regular employees?

A. Yes, sir.

Q. Well, were some of them just what you call special officers or special employees?

A. No, sir; there were five Narcotic Agents.

Q. Including this other special employee?

A. Yes, sir.

Mr. Marcus: That is all, your Honor.

The Court: Anything further?

Mr. Bender: Yes.

(Testimony of Jose Ramirez.)

Redirect Examination

By Mr. Bender:

Q. What do you mean, there were five there, including this other special employee? What designation are you giving him, Mr. Ramirez?

A. Five Narcotic Agents and the special employee.

Q. On May 17th what did Villas tell you concerning the substance of the conversation he had with the defendant? [105]

Mr. Marcus: Who?

Q. (By Mr. Bender): What did Villas tell you concerning the substance of his conversation with the defendant Lozoya?

Mr. Marcus: That is objected to as being hearsay, incompetent, irrelevant and immaterial. It would be a self-serving declaration, hearsay, without the presence of the defendant.

The Court: I will overrule the objection. He may answer.

The Witness: At which time, sir?

Q. (By Mr. Bender): That was on May 17th, at any time before you saw Villas and the defendant at the parking lot at 7:30?

A. Yes, sir. On May 17th, Villas said that the man had ten pounds and was ready to deliver.

Q. About this banana that you say you were eating at the time you had the conversation on May 17th, conversation with the defendant, had you eaten the entire banana at the time you dropped it?

(Testimony of Jose Ramirez.)

A. No, sir.

Q. You had been eating it all the time you had been engaged in conversation?

A. Yes, I would take a bite occasionally.

Q. Was that the prearranged signal?

A. Yes, sir. [106]

Q. At the time you had the conversation with the defendant, before he parked his car parallel with the government car, in other words, during the time that it was out in position in front or roughly in front of the government car, do you recall whether there were any automobiles in the parking lot parked in between that position and the positions of the covering Federal Narcotics Agents?

A. No, sir; there were no cars.

Q. And at the time that the car was parked, that is, the car driven by the defendant Lozoya, had been moved into parallel position to the government car, and at the time that you testified that the defendant Lozoya was removing the sack or the burlap bag from his trunk, do you recall whether there were any cars parked in between that position and the covering officers?

Mr. Marcus: Just a minute, please, Your Honor, I submit that this witness has answered the question before, and he has already testified that he didn't see that car.

Mr. Bender: What car?

The Witness: What car?

Mr. Marcus: The covering car, as you call it.

(Testimony of Jose Ramirez.)

That he never even saw it driven on the lot, he testified.

The Court: I will let him answer.

Mr. Bender: Would you like to have the question read?

The Witness: Yes. [107]

Mr. Bender: Read the question, please, Mr. Reporter.

(The reporter read the pending question as follows: "Q. And at the time that the car was parked, that is, the car driven by the defendant Lozoya, had been moved into parallel position to the government car, and at the time that you testified that the defendant Lozoya was removing the sack or the burlap bag from his trunk, do you recall whether there were any cars parked in between that position and the covering officers?")

Mr. Marcus: You said the "covering car."

Mr. Bender: Read it again, please.

(Whereupon the reporter again read the pending question as follows: "Q. And at the time that the car was parked, that is, the car driven by the defendant Lozoya, had been moved into parallel position to the government car, and at the time that you testified that the defendant Lozoya was removing the sack or the burlap bag from his trunk, do you recall whether there were any cars parked in between that position and the covering officers?")

(Testimony of Jose Ramirez.)

The Court: I overruled the objection.

The Witness: No; I do not recall the car being there.

Q. (By Mr. Bender): You didn't see a car?

A. No; I did not.

Q. I am not sure, your statement "No," is that no, you [108] didn't see the car in between or yes, you did see a car in between?

A. No; I didn't see a car in between.

Q. What is your understanding of the meaning of the word "stuff"?

Mr. Marcus: Just a minute. I submit, your Honor, that that calls for this witness' conclusion.

The Court: Yes; I will sustain the objection.

Mr. Bender: The testimony is that he is a Narcotic Agent and he has been for several years, your Honor.

The Court: Well, he can use some other expression.

Mr. Bender: It is my understanding that that is the common parlance.

Q. Mr. Ramirez, did you ever show a photograph of the defendant Lozoya to any of the covering officers before the evening that they covered this occurrence—in other words, before May 17, 1956?

A. Yes, sir. It was after May 3rd, and between May 17th that I showed these pictures to them.

Q. To whom?

A. To the covering officers.

Q. Directing your attention back to this October 2nd, on or about October 2nd, 1955, that is, I believe,

(Testimony of Jose Ramirez.)

your testimony concerning the Villas transaction,
the Moreno—— A. Yes. [109]

Q. Did you ever see an automobile on or about
this time that was similar to the automobile being
driven by the defendant Lozoya on May 17, 1956?

Mr. Marcus: I object to that as being immaterial:
He saw an automobile that resembled Mr. Lozoya's
car in October.

Mr. Bender: All right, your Honor, to save
time——

Mr. Marcus: I would stipulate that he did. You
can go out on the corner and see it.

Mr. Bender: That is a foundational question. If
he will stipulate to it, I will go on.

Mr. Marcus: Go ahead.

The Court: All right.

Mr. Bender: I accept the stipulation.

Q. In what particulars was this automobile that
you observed on October 2nd, 1955——

Mr. Marcus: Object to the question on the
ground that it is immaterial, your Honor.

Mr. Bender: You have already stipulated.

The Court: I will overrule the objection.

Q. (By Mr. Bender): In what particulars was
the automobile you observed on or about October
2nd, 1955, similar to the automobile driven by de-
fendant Lozoya on May 17, 1956?

A. On October 2nd, 1955, I was negotiating for
a purchase of marijuana from Johnny A. Villas.
The defendant, at the time, [110] Johnny A. Villas,
said that he was awaiting his source of supply and

(Testimony of Jose Ramirez.)

he would be here in approximately 30 minutes. At about noon I observed a 1940 or 1941 cream-colored Chevrolet come to the intersection where I was parked. Johnny A. Villas walked over and spoke to this man. He then returned to the automobile, my automobile, and told me where the marijuana would be located.

Mr. Marcus: Your Honor, I move all that testimony be stricken.

The Court: That may go out, yes.

Mr. Marcus: If counsel had done that sort of trick, and I say "trick" advisedly, before a jury, that would be grounds for a mistrial.

The Court: I will let it go out.

Mr. Bender: Counsel, I resent the remark. What do you mean by "trick"?

Mr. Marcus: You know that sort of evidence isn't admissible, that he was "negotiating" with Villas to buy some stuff and an automobile resembling this one drove by.

Mr. Bender: Counsel, you're going to be surprised to learn that the question I asked calls for an admissible answer.

Will you read the question, please?

Mr. Marcus: The court has already ruled upon it.

The Court: I let it go out. [111]

Mr. Bender: I don't believe the answer was responsive.

The Court: Will you ask the question again, then?

(Testimony of Jose Ramirez.)

Mr. Bender: Would you read the question, please?

(The reporter read the pending question as follows: "Q. In what particulars was the automobile you observed on or about October 2nd, 1955, similar to the automobile driven by defendant Lozoya on May 17, 1956?")

Q. (By Mr. Bender): How did it resemble it? What did it look like as compared to the one defendant was driving on May 17, 1956?

A. It was a cream-colored automobile.

Q. What type?

A. 1940 or '41 Chevrolet sedan, very poor condition. At the time, the front left fender was considerably smashed, part of it was broken.

Q. And what did the driver of this automobile that you observed on October 2nd, 1955, do with the automobile? In other words, did he park it or did he proceed on?

Mr. Marcus: Objected to as being immaterial to these proceedings, your Honor.

Mr. Bender: Your Honor, it is much more material than the questions counsel was permitted to ask, and without——

The Court: I'll overrule the objection.

You may answer.

The Witness: This automobile parked around the corner. [112]

Q. (By Mr. Bender): When?

A. As soon as he drove up to this intersection.

(Testimony of Jose Ramirez.)

Q. And where did this occur?

A. In West Whittier.

Q. Was a man named Villas in the vicinity at this time? A. Yes, sir.

Q. What did he do?

Mr. Marcus: Your Honor, I am not going to try this case for something that happened on October 2nd. I am not interested in that. I don't think the court is either. It is highly immaterial as to anything that happened six months before.

Mr. Bender: No, it is not.

Mr. Marcus: If he asks him the question directly if he saw this defendant on October 2nd, I won't object to that. But certainly any actions or events that transpired at that time have no bearing upon this case.

The Court: I will allow him a little latitude. I'll overrule the objection.

You may go ahead.

Mr. Bender: Read the question, please.

(The reporter read the pending question as follows: "Q. What did he do?")

Q. (By Mr. Bender): What did Villas do?

A. Villas went over and talked to the person driving [113] this automobile.

Q. Directing your attention back to your testimony concerning the May 3rd—on or about May 3rd, 1956, your testimony concerning the office conference in my office, at which time I believe you

(Testimony of Jose Ramirez.)

testified that you were present—— A. Yes.

Q. ——and Mr. Lozoya was present—I am sorry.
——that you were present, that defendant Villas was present, that Villas' attorney Graham was present and also, I believe, Chappell was present?

A. Yes.

Q. You testified to that?

A. Yes. At this time we discussed who the source of supply of John A. Villas had been.

Q. Would you relate the entire conversation and statements made at that time by defendant Villas concerning his source of supply?

Mr. Marcus: We are certainly not bound with respect to what Villas may have said or claimed in the absence of the defendant. I was only concerned as to the directions to establish an agency, and that is all the purpose of the examination was at that time, to show the agency between the present witness and the defendant Villas. I am not concerned as to any statements with respect to this defendant here at that time. I object to it on that ground. [114]

Mr. Bender: Well, counsel, I may have misunderstood your purpose of a portion of your questions on cross-examination. If that purpose is to set forth the theory of entrapment, I would like to know.

Mr. Marcus: Obviously it is for the purpose of entrapment, for one thing, and then to show the agency on the other.

Mr. Bender: All right. Then, your Honor, I cite to the court a case decided by Judge Mathes——

The Court: I'll let you proceed.

(Testimony of Jose Ramirez.)

Mr. Bender: Yes, your Honor. I may as well cite this case, if your Honor would be interested in it. It is a very interesting case on the question of admissibility of all hearsay statements made to the Federal Narcotics Agents as bearing upon their having probable cause to reasonably——

The Court: Well, the court has ruled with you.

Mr. Bender: Yes, your Honor. I thought you might be interested in the case.

The Court: Well, you might work so hard I might change my decision.

Mr. Bender: All right, your Honor.

Q. Would you relate the conversations by defendant Villas? What did he say concerning this defendant Lozoya in the office on May 3rd, 1956?

A. I asked him who his source of supply had been, and he said "Cuckoo." Attorney Graham then gave the name of [115] "Cuckoo" as Refugio Gonzales Lozoya.

I asked Villas what kind of car Lozoya drove, and he said a 1940 or 1941 cream-colored Chevy. I asked him if that was the same one that had arrived on October 2nd right before I bought the marijuana from him, and he said, "Yes."

I then asked Villas to draw me a map of the route that this Chevrolet cream-colored had taken on October 2nd, as I wished to establish the fact that he was positive that this was his source of supply. I didn't want him to say that it was and not recall his actions. Villas then drew me a map of the route taken by this cream-colored Chevrolet, and it coin-

(Testimony of Jose Ramirez.)

cided with what I recalled of the events on October 2nd.

I then asked the defendant Villas whether he could introduce me to Lozoya, and he said that he probably could. I then asked him if he saw him very often, and he said that he didn't see him very often; that Lozoya used to come around at the foundry where he worked.

That is in substance the conversation we held that day, May 3rd.

Q. Now, on May 17, 1956, when the Federal Narcotics Agent Gullen said that, "You're all under arrest," or words to that effect, you didn't believe that you were under arrest, did you?

A. I didn't believe what, sir?

Q. That you, yourself, were actually under arrest? [116] A. No, sir.

Q. Did you arrest Lozoya? A. No, sir.

Q. Then your recollection of anyone that you arrested in connection with a marijuana case is limited to what defendants, if you recall?

A. It is limited to——

Q. That you actually arrested?

A. That I actually arrested?

Q. Yes. That you were the one who said, "I place you under arrest"?

A. There have been none.

Q. What about Villas, Moreno, Ramos—did you actually place them under arrest?

A. No, sir. Villas was arrested by Agent Jones. Ramos was arrested by Agent Goodman and another

(Testimony of Jose Ramirez.)

agent. Rojas was taken in custody by the San Gabriel police department.

Q. Have you been connected with any other marijuana cases since you have been a Narcotics Agent in which you did not make the arrest of the defendant? A. Yes.

Q. What case?

A. I have been connected with the Cancino case, also with a person by name of Rubio Fernandez and a number of heroin cases. [117]

Q. Do you recall ever making an arrest of a defendant in a heroin case? A. Yes, sir.

Q. Who? A. Juarez.

Q. Have you been connected with other cases concerning the defendants who were apprehended for heroin in which you did not make the arrest?

A. Yes, sir.

Q. Do you recall any of them?

A. I recall a Sanchez—Frank Sanchez, and Hernandez that I didn't make the arrest, also I think a person named Penulas (phonetic) that I did not make the arrest, a person by name of Galvan that I didn't make the arrest.

Mr. Bender: Mr. Fisher (the clerk), would you mark this as Government's Exhibit 1.

If he marks the outer package, we will have several other cards. If counsel doesn't object, I would like to have the witness open it, until we get down to the last one.

Mr. Marcus: No objection.

(Testimony of Jose Ramirez.)

Q. (By Mr. Bender, handing the exhibit to the witness): Before you open it, Mr. Ramirez, have you seen this package before? A. Yes, sir.

Q. When is the first time you saw it? [118]

A. Up in the office of the Bureau of Narcotics today after the recess, this morning's recess.

Q. Where did you obtain it?

A. From the office of the Bureau of Narcotics.

Q. And what did you do with it after you obtained it?

A. I took it and placed it on my desk until we came to court.

Mr. Bender: I believe I have reconsidered and would like that the clerk mark the outer package as Government's Exhibit 1.

The Court: All right.

Mr. Bender: That way it indicates the material contained in it.

Would you like to inspect it?

Mr. Marcus: It hasn't been opened yet.

Mr. Bender: I mean the outer carton.

The Court: Well, we will get it marked as an exhibit, and that might be a good time to stop.

Mr. Bender: All right.

The Court: We have marked it as Exhibit 1 for identification.

(The exhibit referred to was marked Plaintiff's Exhibit No. 1 for identification.)

The Court: The clerk has to put it away for tonight.

(Testimony of Jose Ramirez.)

Isn't that right? [119]

The Clerk: Yes.

The Court: All narcotics go in the vault. That takes care of it around the courtroom here.

Do you want to make it about 9:45?

Mr. Marcus: Yes, your Honor.

Mr. Bender: That is fine, your Honor. It is taking longer than I anticipated.

The Court: 9:45, because I told Mr. Bowler and the other gentlemen that maybe we would draw a jury for a case on Friday.

Mr. Bender: 9:45 is perfectly agreeable.

The Court: All right. Make it 9:45 tomorrow.

Mr. Marcus: Have you finished with this witness, counsel?

The Court: No, he hasn't.

Mr. Bender: No.

The Court: Make it 9:45 tomorrow morning.

Mr. Marcus: Surely.

The Court: All right.

(Adjournment until Wednesday, July 18, 1956, at 9:45 a.m.) [120]

Wednesday, July 18, 1956, 9:45 A.M.

Mr. Bender: So that there can be no possible confusion concerning Government's Exhibit 1 for identification, it is the Government's intention to have the last package that is opened be marked Government's Exhibit 1, because that would then coincide with the statement contained in the written

stipulation, which is Government's Exhibit 2 for identification.

The Court: All right.

Mr. Bender: Perhaps the clerk could mark the outer package as Government's Exhibit 1-A.

The Court: All right.

(The exhibit referred to was marked Government's Exhibit 1-A for identification.)

Mr. Bender: And we can mark the successive wrappings B and C.

The Court: All right.

JOSE RAMIREZ

called as a witness on behalf of the plaintiff, having been previously sworn, resumed the stand and testified further as follows:

Redirect Examination

(Continued)

By Mr. Bender:

Q. Mr. Ramirez, I place before you Government's Exhibit [123] 1-A for identification and ask you if you have seen it before?

A. Yes, I have, sir.

Q. When and where?

A. In the office of the Bureau of Narcotics.

Q. When was that? What did you do with it after you saw it?

A. I took it in my possession and brought it to court yesterday.

Q. And it was in your possession until it was

(Testimony of Jose Ramirez.)

marked yesterday as Plaintiff's Exhibit 1 for identification? A. Yes, it was.

Q. Would you open the outer wrappings which is marked Plaintiff's Exhibit 1-A for identification only? A. (Witness opening package.)

Q. Before you now appears to be another package.

Mr. Bender: May we have the clerk mark that as Government's Exhibit 1-B for identification?

The Court: All right.

(The exhibit referred to was marked Government's Exhibit 1-B for identification.)

Mr. Bender: As we go along, Mr. Marcus, if you would like to inspect any of the exhibits for identification, they are available.

I observe that contained on the front of Government's Exhibit 1-B for identification is the Treasury Department [124] Bureau of Narcotics stamp, but I don't believe that has anything to do in particular—perhaps I should state it this way: I don't believe that counsel would prefer that go into evidence as a portion of the anticipated marijuana exhibit. Of course, you may look at it.

Mr. Marcus: Take it off.

Mr. Bender: All right, I'll tear it off.

(Mr. Bender tearing off the item referred to.)

Q. (By Mr. Bender): Mr. Ramirez, would you open Government's Exhibit 1-B for identification?

A. (Witness opening package.)

(Testimony of Jose Ramirez.)

Q. Open it all the way, Mr. Ramirez. See what we discover inside.

A. (Witness complying.)

Q. What is inside the exhibit?

A. A number of paper sacks, with my initials written thereon.

Q. Are your initials on all of the sacks?

A. I couldn't tell without inspecting all of them.

Q. Inspect them, please.

Mr. Marcus: Your Honor, for the purpose of the record at this time, may the record show that the witness has opened the original container, that he is now removing the sacks from the original carton container, that each of the sacks are open and not sealed? [125]

The Court: All right.

The Witness: Yes, sir, my initials are on each package. There is also included a burlap sack, which also includes my initials.

Mr. Bender: Your Honor, at this time the Government offers into evidence as Government's Exhibit 1-A the outer wrapping on the carton or package, 1-B, the box in which the material was contained, and as Government's Exhibit 1 the contents of the box which is Government's Exhibit 1-B for identification only.

Mr. Marcus: Your Honor, may I at this time take the witness on voir dire?

The Court: Yes.

(Testimony of Jose Ramirez.)

Voir Dire Examination

By Mr. Marcus:

Q. Mr. Ramirez, you state that your initials are on these various sacks? A. Yes, sir.

Q. You notice that all of the sacks are open, do you not? A. Are what?

Q. Are open—they are not sealed?

A. Yes, sir.

Q. Now, sir, did you place—that is, did you personally take the sacks and place them in the carton? [126] A. Yes, sir.

Q. When did you do that? A. On May 18.

Q. Were the packages sealed at that time?

A. No, sir.

Q. Were the packages open at that time?

A. Yes, sir.

Q. Did you examine each of the packages that are contained in the carton at this time?

A. Yes, sir, I did.

Q. Before you sealed it? A. Yes.

Q. Then you sealed the package? A. Yes.

Q. What day was that? A. May 18.

Q. 1956? A. Yes, sir.

Q. And then what did you do with the package?

A. I mailed it by registered mail to the chemist.

Q. Now, since that time you have not, as I understand, seen the package? A. No, sir.

Q. It has not been in your possession?

A. No, sir, until it arrived yesterday. [127]

(Testimony of Jose Ramirez.)

Q. Until it arrived yesterday? Now, have you examined the contents of the package since it arrived yesterday? A. Only here.

Q. Well, the contents of it, have you examined it? What is in the sacks? A. No, sir.

Q. You don't even know what is in the sacks at this time, do you?

A. I presume that it is——

Q. I don't want you to presume anything.

A. I have not checked the contents, no.

Q. So you don't know what is even in the sacks?

A. I have not checked.

Q. You don't even know whether it is the same material that you sent to San Francisco, do you?

A. The mail that I mailed to San Francisco bore my initials.

Q. Yes, sir, but these packages are all open now and you don't know whether the material contained in these packages are the same as you mailed to San Francisco, do you?

A. The package was not opened. I opened it right now.

Q. I am not talking about the carton. I am talking about these various paper sacks here. You see this sack, for instance? A. Yes. [128]

Q. It is open, isn't it? A. Yes, sir.

Q. You haven't even looked at it from the witness stand, have you? A. No, sir.

Q. And you didn't look at it since it came back from San Francisco? A. No.

Q. You don't even know what is in the package

(Testimony of Jose Ramirez.)

that is open, do you? A. That is right.

Mr. Marcus: Obviously at this time it is not admissible in evidence, your Honor.

Mr. Bender: Your Honor, the Government requests that the clerk mark one of the sacks contained in the box with the Government's Exhibit 1-B for identification, marked as Government's Exhibit 1.

Inspect one, Mr. Ramirez, and be certain that it contains your initials, and examine the sack's contents and satisfy yourself, if you are able, that it appears to resemble marijuana.

Mr. Marcus: Just a moment. That is leading and suggestive. I have already stipulated in the record here with respect to the contents, but that doesn't make the evidence admissible by any stretch of the imagination. This witness [129] doesn't know what is in there at the present time, and even though he should testify that he now examines the contents he would have to establish the fact that this is the evidence that was sent to San Francisco—the contents of it. I don't care about the sacks. We're not interested in that.

The Court: I'll overrule the objection. I'll let him answer.

(The exhibit referred to was marked Government's Exhibit 1 for identification.)

Mr. Bender: Examine one of the contents of the sacks, Mr. Ramirez—in fact, examine the contents of every sack.

(Testimony of Jose Ramirez.)

The Court: Just one will be enough.

Mr. Bender: Just one suffice, your Honor?

The Court: I think so, at this time.

The Witness: I have examined this sack. It bears my initials.

Q. (By Mr. Bender): What did you find inside the sack? What did the contents appear to be?

A. It appears to be——

Q. What does it appear to resemble?

A. It appears to resemble marijuana.

Q. Does it resemble the substance which you placed in this sack? A. It does.

Q. Before mailing it to San Francisco? [130]

A. It does.

Mr. Marcus: That is assuming facts not in evidence. He didn't testify that he placed anything in the sack.

The Court: I'll overrule the objection.

Q. (By Mr. Bender): Mr. Ramirez, did you place anything in this sack before mailing the sack?

A. Did I place anything inside the sack?

Q. Yes. A. No, sir.

Q. Did anyone place anything inside the sack in your presence? A. Not in my presence.

Q. What did you do with the substance which you received from defendant Lozoya after you weighed it in the Federal Narcotics office on May 18, 1956?

A. After I weighed it, I placed it in this box. The substance was in these original containers.

Q. In what original containers?

(Testimony of Jose Ramirez.)

A. In these paper sacks.

Q. You mean it was in it at the time you received it or obtained it? A. Yes, sir.

Q. And each of these paper sacks, then, was contained with the contents of the paper sacks as you know it to have been contained in the burlap [131] sack? A. Yes, sir.

Mr. Bender: Counsel, it is the Government's intention to place all of these sacks back into the burlap container and have it marked as Government's Exhibit 1 for identification.

Mr. Marcus: You may do it, if you wish, but I don't see any reason for that, whether he puts it in there or keeps it in the paper containers.

Mr. Bender: All right. Would you mark as Government's Exhibit 1 the burlap sack?

So that there will be no misunderstanding, counsel, does the scope of your written stipulation, which is Government's Exhibit 2, include the substances which are contained within the various paper sacks and include the burlap bag they are all contained in and were contained in Government's Exhibit 1-B for identification?

Mr. Marcus: Well, the stipulation speaks for itself. You see, counsel misses the point that I am making here. There is no evidence at this time in this record that the substance that this gentleman claims that he mailed to San Francisco is the same substance that was examined in San Francisco. There is absolutely not one word of testimony in

(Testimony of Jose Ramirez.)

this record that what he sent to San Francisco was marijuana.

Mr. Bender: But counsel, the scope of your stipulation is that you will stipulate that the substance to be identified [132] by Agent Ramirez as Government's Exhibit 1 is, in the opinion of R. F. Love, marijuana.

Mr. Marcus: That is not the stipulation.

Mr. Bender: Yes.

Mr. Marcus: Have you got it?

Mr. Bender: In particular, look at subparagraph B of the stipulation. The Agent having identified the material——

Mr. Marcus: Wait a minute; let's look at the stipulation I signed.

1. That R. F. Love is duly qualified to examine and analyze narcotic drugs and testify as an expert witness concerning their nature and identity;
2. R. F. Love, if called as a witness at the trial of the above-entitled case would testify under oath that it be deemed that he would so testify as follows: 2A. That he is a chemist employed by or acting on behalf of the Narcotics Bureau of the United States Treasury Department in San Francisco, California.

Mr. Bender: B. That in his employment, in the course of his duties as a chemist, he examined and analyzed Government's Exhibit 1 for identification (which will be identified by Narcotic Agent Jose Ramirez)—after having received said exhibit by registered mail from Agent Ramirez and the Fed-

(Testimony of Jose Ramirez.)

eral Bureau of Narcotics at Los Angeles, California; C. That the analysis made by said R. F. Love reveals that, in his opinion, said Exhibit 1 for identification consists of approximately [133] nine and a half pounds of marijuana.

Now, Agent Ramirez has identified this substance and it is marked as Government's Exhibit 1 for identification. According to your stipulation, you are stipulating that R. F. Love would testify that, in his opinion, it is marijuana.

Mr. Marcus: Counsel, you miss the point yet. Ramirez hasn't testified that the substance that he saw in the package is the same substance that is in there.

Mr. Bender: But counsel, you miss the point. You stipulated that what is identified by Agent Ramirez as Government's Exhibit 1 will be testified to by R. F. Love as having been deemed to be marijuana.

Mr. Marcus: But this witness has not testified yet that what he saw in the package is the same as is in the package now.

Mr. Bender: He testified that it resembles it.

Mr. Marcus: I don't care if it resembles it. It resembles anything, as I will bring out—it resembles alfalfa, it resembles a lot of things. That isn't the question, what it looks like. The question is whether it is the same. There is the point.

I will submit it, that's all. It speaks for itself.

Mr. Bender: Counsel, Agent Ramirez has testi-

(Testimony of Jose Ramirez.)

fied that he did not place the substance in the individual packages.

Mr. Marcus: Judge, may I ask him a couple of questions? [134]

The Court: All right.

Mr. Marcus: I will clear this up in just a minute.

Q. Mr. Ramirez, you have examined the contents of one sack? A. Yes, sir.

Q. Can you tell this court that that is the identical substance that you sent to San Francisco? Yes or no. A. The substance——

Q. Yes? A. No, sir.

Mr. Marcus: That is all.

Q. (By Mr. Bender): Mr. Ramirez, you have examined the contents of the sack. Does it appear to be or to resemble the substance that you sent to San Francisco? A. Yes; it does.

Mr. Marcus: Permit me, your Honor.

Q. This resembles alfalfa, too, doesn't it?

A. No, sir. Alfalfa is coarser stems, larger stems——dried alfalfa.

Q. Well, it resembles a lot of things, doesn't it?

A. Yes; it does.

Q. So you can't tell us definitely at this time that that was the same substance that you sent to San Francisco, can you?

A. I didn't say it was the same. I said it resembled [135] it.

Q. My question is, you can't definitely tell us, under oath, that it is the same substance, can you?

A. No, sir.

(Testimony of Jose Ramirez.)

Mr. Marcus: That is all.

Mr. Bender: Counsel, are you contending that this is not the substance that was received by the chemist in San Francisco?

Mr. Marcus: Let me suggest, counsel, that this is your burden, this is your case. I can't make the case for you. I am not going to stipulate that this is the same substance that this witness claims that he took from this party. I'm not going to stipulate that the substance that he took from this defendant is the identical stuff that is in that sack, because I don't know, and neither does the witness you have called.

Mr. Bender: But if you are contending that this is a link in the chain that is missing, that is not covered by the scope of our stipulation, then we can certainly produce the chemist, who will, I presume, testify that this is the substance he received from the Federal Narcotics Bureau.

Mr. Marcus: That is exactly what I stipulated to, that he received something.

The Court: He is not disputing about the chemist. The chemist would only testify that, in his opinion, the material [136] he examined was marijuana.

You're not disputing that?

Mr. Marcus: No, sir; I'm not. That is the stipulation.

The Court: He is disputing and putting the Government on proof to trace it to the defendant, and that is missing at this time by reason of the

(Testimony of Jose Ramirez.)

fact that this witness does not say positively that this is the same substance.

Mr. Marcus: He hasn't testified that this is the substance that he took from this party.

The Court: That is right.

Mr. Marcus: He hasn't testified that this is the identical substance that he sent to San Francisco. There is a link missing—there are two links, Judge.

The Court: Well, I said one. I don't know.

Mr. Bender: All right, what are those links?

Mr. Marcus: Counsel, I am just making an objection. This witness cannot testify—I'll assist you here, just mark it down—this witness has not testified that the substance contained in this sack is the identical substance that he claims he received from this defendant.

Mr. Bender: That isn't a link.

Mr. Marcus: That isn't a link?

Secondly, there is no evidence here that this is the same substance that was sent to San Francisco by this Agent.

Mr. Bender: Counsel, in lines 7 and 8 on page 1 of your [137] stipulation you say, "after having received said exhibit by registered mail from Agent Ramirez * * *" Are you not stipulating that this Exhibit 1, just identified by the Agent Ramirez, was the exhibit that was received by R. F. Love in San Francisco from Agent Ramirez?

Mr. Marcus: I am not disputing that. But you haven't laid the foundation that this witness knows that this is the same substance that he received from this defendant. There is where your link is missing.

(Testimony of Jose Ramirez.)

Mr. Bender: He knows it is the same substance.

Mr. Marcus: I asked the witness if that is the same substance that he took from this party; not whether it looks like it.

The Court: The court will ask him.

Is this the same substance that you took from the defendant?

The Witness: It is.

The Court: How do you know that?

The Witness: Because I did not remove any substance.

The Court: Did you mark it?

The Witness: No, sir. I marked the package. It is an impossibility to mark——

The Court: Did you put your initials on anything?

The Witness: I put my initials on these packages, on all of them. [138]

Mr. Marcus: Mr. Ramirez, you just testified a moment ago that you don't know whether that is the same substance or not. Didn't you tell me that in response to my question?

The Witness: The Judge worded it differently.

The Court: Straighten him out, then.

Mr. Marcus: Mr. Ramirez, tell us whether or not you can testify under oath that this is the same substance you took from the defendant?

The Witness: No.

The Court: You may proceed.

Q. (By Mr. Bender): Mr. Ramirez, before sealing and mailing the substance which you received

(Testimony of Jose Ramirez.)

from the defendant Lozoya, did you inspect the contents of any of those sacks? A. Yes; I did.

Q. Did you inspect the contents of all of them—look at them? A. Yes, I did.

Q. What did the substance appear to resemble?

A. It appeared to resemble marijuana.

Mr. Marcus: I move that that be stricken as calling for a conclusion, what did it appear to resemble? Your Honor, there is no foundation to establish the fact that he is competent to testify to what it looks like.

The Court: He is not positive. He said it appears like it. [139]

Mr. Bender: He is not testifying as an expert witness.

Mr. Marcus: Your Honor, I have seen marijuana many, many times—I have represented many, many clients with respect to matters of this kind, and I can't testify what it looks like.

The Court: Well, he is not testifying as a chemist. It goes to the weight and credibility. He just stated that it appeared like it.

Mr. Marcus: All right.

Mr. Bender: With reference to the other discussion, counsel, I am not certain I recall whether you acquiesced in my request or not, to this extent: That the burlap bag and all of the various smaller paper sacks containing initials are to be deemed to be Government's Exhibit 1 for identification.

Mr. Marcus: Yes, sir; I acquiesce in it and stipulate to it.

(Testimony of Jose Ramirez.)

The Court: All right.

Mr. Marcus: I am not making any objection to any technical matters here. This is the substance that I am objecting to. The objections I have made as to substance as to whether or not it is in the burlap bag or whether or not you put it in the burlap bag or whether or not it is considered one—I make no objection to that, counsel. I understand and stipulate for the record at this time that the burlap bag, the paper sacks contained and the paper carton are all your [140] exhibits and may be considered as such no matter what number or designation you give them. Is that understood for the record?

Mr. Bender: Yes. It appears, then, that the only thing, according to this approach that the Government has not tied in here is that the chemist would testify that he received this substance and that the identical substance remained in those various paper bags and that he returned the same substance and the same paper bags.

Mr. Marcus: I am not making that objection.

The Court: He is not claiming that. He is complaining, really, of your first link.

Mr. Bender: What is that, your Honor?

The Court: Well, that the substance that he took from the defendant in this case is marijuana and is the same substance that is here identified. I don't know, maybe I am injecting—I thought that was the point.

Mr. Marcus: That is the point exactly.

(Testimony of Jose Ramirez.)

The Court: You are not contending about the chemist?

Mr. Marcus: No; I have stipulated to that.

The Court: You are complaining of the link between the defendant and what is in the sack?

Mr. Marcus: Yes.

The Court: It is really what you call the corpus delicti.

Mr. Marcus: Right. [141]

Mr. Bender: Counsel, then if you are not complaining on that point, will you stipulate to that point?

Mr. Marcus: Please.

(There was an interruption at this point while the court took up another matter briefly.)

Mr. Bender: Counsel, I don't want to belabor the point, but I want to make certain that this portion has been stipulated to: That the contents of the various paper bags which are marked as a portion of Government's Exhibit 1 for identification contain the substance which R. F. Love would testify is marijuana.

Mr. Marcus: Well, let me say that I think that the stipulation speaks for itself. I make no issue with respect to what Mr. Love would testify to.

The Court: You have no disagreement with the stipulation. It is just the question of putting the Government to proof on this particular point?

Mr. Marcus: Right.

Mr. Bender: Your Honor, the Government an-

(Testimony of Jose Ramirez.)

ticipated that the scope of the stipulation covered the problem. If counsel does not agree to the statement I have just made, and that was the Government's understanding of what we stipulated to, and that being so and counsel doesn't agree that we stipulated to that, then we will have to call the chemist from San Francisco. [142]

The Court: It is not really necessary to call the chemist, under the stipulation, because under the stipulation Mr. Marcus is going to agree with you, Mr. Bender, that the substance that the chemist examined was marijuana.

Mr. Marcus: Right.

Mr. Bender: Well, will he further stipulate, and have we not stipulated, that the contents of those paper bags marked Government's Exhibit 1 is marijuana, in the opinion of R. F. Love?

Mr. Marcus: Yes, sir; there is no dispute as to that; he would testify under oath with respect to that.

Mr. Bender: That is what I asked you.

Mr. Marcus: Yes.

The Court: Well, we don't need to bring the chemist down. There is no dispute on that.

Q. (By Mr. Bender): Mr. Ramirez, are the burlap bags and the various paper sacks marked as Government's Exhibit 1 for identification only the material that the defendant Lozoya placed in the Government automobile on May 17th?

A. It is.

Mr. Marcus: Just a moment. That is objected to

(Testimony of Jose Ramirez.)

as assuming facts not in evidence. This witness has already testified that he does not know that the contents of the sacks is the same as the purported contents of the sacks that were placed in his car allegedly by this defendant. [143]

Mr. Bender: I will break it down to this extent, your Honor——

Mr. Marcus: That has been asked and answered.

The Court: Yes; that may go out, his last answer may go out.

Q. (By Mr. Bender): Mr. Ramirez, are the burlap bag and the paper sacks which you have identified with your initials on them and which are marked as Government's Exhibit 1 for identification only, are they the burlap bag and the various paper bags which you obtained from the defendant Lozoya on May 17th, 1956?

Mr. Marcus: That is objected to as assuming facts not in evidence, your Honor. He hasn't testified that he obtained it from the defendant at all.

Mr. Bender: He has.

Mr. Marcus: He testified that the defendant placed them in his car. He hasn't testified that he obtained them from the defendant.

Mr. Bender: One further question:

Q. Mr. Ramirez, are the burlap bag and the various paper sacks which you have identified as containing your initials and which have been marked as Government's Exhibit 1 for identification only the material which the defendant Lozoya placed in the trunk of the Government's automobile

(Testimony of Jose Ramirez.)

at the Beverly Ranch Market on May 17, [144] 1956?

Mr. Marcus: Just a minute, please, before you answer that.

Now, it is understood that this witness is simply testifying as to the containers, not the substance that is in the containers; is that correct?

Mr. Bender: Absolutely correct.

Mr. Marcus: I won't object to the question.

The Court: You may answer.

The Witness: Yes, it is.

Q. (By Mr. Bender): And at the time you examined the contents of the various paper bags, or at the time you examined the various paper bags, did they contain any substance? A. Yes.

Q. And you examined those on May 18, 1956?

A. I examined them on May 17th.

Q. And you examined them again on May 18, 1956? A. Yes; I did.

Q. Did they appear to contain the same substance which is presently contained in them?

Mr. Marcus: Just a moment. That is objected to as having been asked and answered.

The Court: I'll sustain the objection. That has been covered.

Q. (By Mr. Bender): Mr. Ramirez, the burlap bag and the various paper sacks which you have identified as containing [145] your initials, are those the ones which were placed by you in the box which is marked Government's Exhibit 1-B for identification? A. Yes, sir; they were.

(Testimony of Jose Ramirez.)

Q. Are they also the ones that you then mailed or caused to be mailed by registered mail to San Francisco? A. Yes; they are.

Q. To the chemist, to the Narcotics Bureau, to the Treasury Department in San Francisco?

A. Yes, sir.

Q. And to R. F. Love, the chemist, in San Francisco? A. Yes, sir.

Mr. Bender: At this time, the Government offers into evidence as Government's Exhibit 1-A the outer wrapping which enclosed the large box which is Government's Exhibit 1-B for identification.

Mr. Marcus: Will your Honor reserve ruling on this until at least we have a chance to cross-examine the witness?

The Court: All right; I will reserve the ruling.

Mr. Bender: And at the same time the Government offers into evidence as Government's Exhibit 1-B, the large paper carton box which contains Government's Exhibit 1.

The Government further offers into evidence Government's Exhibit 1, which consists of the burlap bag, the various paper sacks containing the initials of Agent Ramirez and the contents [146] of the various paper sacks, as Government's Exhibit 1.

The Government further offers into evidence, as Government's Exhibit 2, what has heretofore been marked as Government's Exhibit 2 for identification only and which is the stipulation of facts and order thereon.

Mr. Marcus: With respect to the stipulation of

(Testimony of Jose Ramirez.)

facts, your Honor, and the order thereon, there is no objection.

With respect to the other matters, we request the court to reserve ruling.

The Court: I will reserve the ruling on that.

(The exhibit heretofore marked Plaintiff's Exhibit 2 received in evidence.)

PLAINTIFF'S EXHIBIT No. 2

United States District Court for the Southern
District of California, Central Division

No. 25033—CD—(Criminal)

UNITED STATES OF AMERICA,

Plaintiff,

vs.

REFUGIO GONZALEZ LOZOYA,

Defendant.

STIPULATION OF FACTS AND
ORDER THEREON

It Is Hereby Stipulated by and between plaintiff, United States of America, and defendant, Refugio Gonzalez Lozoya, through their respective counsel, in the above-entitled action, that:

1. R. F. Love is duly qualified to examine and analyze narcotic drugs and to testify as an expert witness concerning their nature and identity.

(Testimony of Jose Ramirez.)

2. R. F. Love, if called as a witness at the trial of the above-entitled case, would testify under oath, and it be deemed that he has so testified as follows:

a. That he is a chemist employed by or acting on behalf of the Narcotics Bureau of the United States Treasury Department in San Francisco, California;

b. That in his employment in the course of his duties as a chemist he examined and analyzed Government's Exhibit No. 1 for identification (which will be identified by Narcotic Agent Jose Ramirez) after having received said exhibit by registered mail from Agent Ramirez and the Federal Bureau of Narcotics, Los Angeles, California;

c. That the analysis made by said R. F. Love reveals that in his opinion said Exhibit No. 1 for identification consists of approximately nine and one-half pounds of marijuana.

Dated: July 16, 1956.

LAUGHLIN E. WATERS,
United States Attorney;

LOUIS LEE ABBOTT,
Assistant U. S. Attorney,
Chief, Criminal Division;

/s/ JOSEPH F. BENDER,
Assistant U. S. Attorney, Attorneys for Plaintiff,
United States of America.

(Testimony of Jose Ramirez.)

/s/ DAVID C. MARCUS,
Attorney for Defendant.

It Is So Ordered:

This 18th day of July, 1956.

/s/ THURMOND CLARKE,
United States District Judge.

Admitted in evidence July 17, 1956.

Mr. Bender: The Government further requests that the court sign its approval of the stipulation of facts as Government's Exhibit 2.

The Court: There is no quarrel on that, is there, Mr. Marcus?

Mr. Marcus: No quarrel, your Honor.

The Court: I will just reserve the ruling on the one large package and the containers.

Mr. Bender: It is Government's Exhibit 1-B for identification and Exhibit 1.

The Court: Yes; you have offered them in evidence, and the court reserves ruling on them.

Mr. Bender: Also on the outer wrapping, Government's [147] Exhibit 1-A?

The Court: I don't think it makes a great deal of difference, but we might as well be consistent. We might as well have the outer wrapping, too.

Mr. Bender: Yes.

Q. (By Mr. Bender): Mr. Ramirez, you testi-

(Testimony of Jose Ramirez.)

fied concerning conversations with a man named Villas in the office of the United States Attorney on or about May 3rd, 1956. Subsequent to those conversations, or that conversation, what did you do with reference to the inspection of records or documents of the State concerning the man named Lozoya?

Mr. Marcus: That is objected to as being immaterial, what he did and what records or documents he examined.

Mr. Bender: Your Honor, counsel has stated that one of his defenses is the theory of entrapment.

Mr. Marcus: I haven't put on any defense at all yet, and I can change my theory and I don't have to adopt one. It makes no difference. That doesn't give counsel a right to anticipate what my defenses may happen to be.

The Court: I'll overrule the objection.

Mr. Marcus: Did he examine the State records, your Honor?

The Court: I'll overrule the objection. I'll allow him some latitude here.

You may answer. [148]

The Witness: Yes, sir. I went to the——

Q. (By Mr. Bender): What records—what did you do?

A. I went to the Sheriff's county identification and record division. I requested information on a person named Refugio Gonzales Lozoya, with his

(Testimony of Jose Ramirez.)

approximate age, his height and his weight. I was shown——

Mr. Marcus: Your Honor, this is obviously hearsay.

Mr. Bender: No, your Honor; that is exactly the point. The only possible objection that counsel for the defendant, from the Government's perspective, could make is that this more properly be presented in rebuttal.

Mr. Marcus: In rebuttal to what?

Mr. Bender: In rebuttal to a defense of entrapment.

Mr. Marcus: I haven't put on any defense yet. I don't understand how counsel at this time, with his experience, could anticipate what the defense may be and then in his case in chief introduce evidence in purported rebuttal of what we may use as a defense.

Mr. Bender: Counsel, you stated that one of your defenses would be entrapment and you went into cross-examination rather fully in an attempt to elicit the defense of entrapment. I asked you at the time if I was misconstruing or misunderstanding your intended purpose or your intended defense, and yesterday you advised me that one of your defenses was entrapment. You having gone into the matter on [149] cross-examination, having commenced to lay the foundation to set up a purported defense of entrapment, you have opened the door to us at this time to present this testimony.

Now, under any circumstances, it would be proper

(Testimony of Jose Ramirez.)

rebuttal testimony, and in the absence of a jury it appears, if the court in its discretion would be willing to entertain it now rather than calling this witness back, it appears to the Government that that is proper, you having opened the door to it.

Mr. Marcus: Please; I don't need any lecture on the trial of cases. I submit, your Honor, at this time that the defendant's plea of not guilty to a charge obviously permits him to cross-examine any witness on any theory of his case.

The Court: Well, the court has ruled. The court has sustained the objection. That is as far as I will let him go at this time.

Mr. Bender: You may cross-examine.

Recross-Examination

By Mr. Marcus:

Q. Do you have your files and records here pertaining to this case? A. No, sir; I don't.

Q. Where are they? A. Upstairs.

Q. Did you look at them this morning? [150]

A. No; I didn't.

Q. When did you look at them last?

A. Yesterday noon.

Q. You say you, personally, took this package to the post office? A. Beg your pardon?

Q. Did you, personally, take this package to the post office? A. Yes; I did.

Q. And you registered it, did you?

A. Yes.

(Testimony of Jose Ramirez.)

Q. Do you have the registration certificate at the time of mailing? A. Not here, sir.

Q. Do you have it, I asked?

A. I gave it to the secretary. I do not keep——

Q. Well, do you have it in your custody or available to you to show that you, personally, mailed this? You said that you, personally, registered that package? A. Yes, sir.

Q. You got a registered receipt at the time you registered it, didn't you? A. Yes, sir.

Q. Where is it?

A. Upstairs in the office of the Bureau of Narcotics. [151]

Q. Is it in your possession and under your control? A. No, sir.

Q. Well, what did you do with it?

A. I gave it to the secretary and she has a special place for it.

Q. Did you see it, actually see the registered card in the file of this case? A. No, sir.

Q. You don't even know whether there is a registered card, do you?

A. I received one from the postmaster.

Q. Then you do know there is a registered receipt? A. Yes; I do.

Q. After having registered that package, as you say you did personally, you requested a return receipt, didn't you? A. Yes, sir.

Q. Did you receive it back from San Francisco?

A. I do not know.

Q. You don't know, personally, whether or not

(Testimony of Jose Ramirez.)

that same package was received in San Francisco, do you? A. By what——

Q. Do you, please? Just answer yes or no.

A. I'm afraid I can't answer that question.

Q. Not having seen or received back a registered receipt card on this very package that you say you mailed, you don't [152] know whether or not it was actually received in San Francisco, do you?

A. I do not receive those receipts personally.

Q. Well, you signed for it; it was in your name, wasn't it? A. No, sir.

Q. When you registered it, it was registered in your name, wasn't it? A. No, sir.

Q. In whose name was it registered?

A. It was registered to the office of the Bureau of Narcotics, Room 1755.

Q. Well, you signed for it at the time, didn't you? A. No, sir; you don't sign anything.

Q. Well, I would like to see that card, if it is available to you, whether or not you actually signed for the registered package.

A. No, sir; you don't sign for it.

Q. Well, whether you do or don't, I would like to see that card. When you register a package in registered mail you sign your name, don't you?

A. No, sir.

Q. You didn't sign your name in this instance?

A. No, sir.

Q. Do you have that card? [153]

A. I do not have it here, no.

Q. Is it upstairs?

(Testimony of Jose Ramirez.)

A. I presume it is, yes.

Q. Will you examine your records and see if it is there? A. Yes, sir.

Q. All right, sir. Now, you testified yesterday afternoon that on October 2nd, 1955, you saw a yellow car driving around a corner; is that right?

A. No, sir.

Q. Didn't you testify that you saw a yellow 1941 Chevrolet automobile? A. No, sir.

Q. What did you testify to with respect to a yellow automobile?

A. I did not testify with respect to a yellow automobile.

Q. What color was it?

A. Light, cream-colored automobile.

Q. Light, cream-colored automobile?

A. Yes.

Q. Well, did you see one go around the corner, a light, cream Chevrolet automobile?

A. I saw one pass close to my car.

Q. Well, how many light, creamed automobiles have you [154] seen pass close to your car since October? A. I haven't kept track.

Q. Hundreds of them, haven't you?

A. I don't know.

Q. Well, have you seen any?

A. Not that I recall.

Q. But you definitely remember seeing one on October 5 of last year? A. Yes, sir.

Q. And you don't recollect seeing any since that time? A. No.

(Testimony of Jose Ramirez.)

Q. A light, creamed automobile?

A. No, sir.

Q. Now, Mr. Ramirez, as a matter of fact, you don't recollect seeing any cream-colored automobile pass near your car on October 5, 1955, do you?

A. I do.

Q. You do? A. Yes.

Q. All right. Let's just take this morning, for instance. You came to work in an automobile, did you? A. Yes, sir.

Q. Do you know that you passed any automobiles on the highway? A. Yes; I do. [155]

Q. Do you remember passing any of any distinct color? A. Yes; I do.

Q. You have a definite recollection of passing cars of different color this morning? A. Yes.

Q. Did you pass one of a light, cream color?

A. No, sir. I mean by that, I don't recall.

Q. That you don't recall?

A. I have one recollection of one car.

Q. Not being able to recall whether you passed a light, cream-colored automobile even as close as this morning, you are able to tell us, under oath now today, that last October 5 a cream-colored automobile passed your automobile; is that right? Do you want this court to believe that?

A. I do; yes, sir.

Q. Did you take a license number off that car?

A. No, sir.

Q. Did you make any record, any written record at all of that car passing you? A. Yes, sir.

(Testimony of Jose Ramirez.)

Q. Where is the written record?

A. It is upstairs in the office.

Q. When did you last look at that written record?
A. Yesterday.

Q. Did you have to refresh your memory before testifying [156] from that written record of the yellow car passing you?

A. Cream-colored, sir.

Q. Or the cream-colored car? A. No, sir.

Mr. Bender: That is objected to on the ground that it is asking for a conclusion of the witness, what he had to do. He is asking for an opinion.

Q. (By Mr. Marcus): Well, did you?

The Court: He is reframing the question.

Mr. Marcus: I will reframe it.

Q. Did you examine the written record yesterday afternoon of that cream-colored automobile passing your car on October 5 in order to testify today concerning that subject?

A. October 2nd, sir.

Q. October 2nd?

A. I looked at the file, yes.

Q. That doesn't answer the question. The question is, did you require—— A. No, sir.

Q. Was it necessary for you to refresh your memory? A. No, sir.

Q. Do you remember where you were on October 5th? Do you remember where you were on October 5, 1955, without refreshing your memory; is that right, sir? A. October 2nd? [157]

Q. October 2nd.

(Testimony of Jose Ramirez.)

The Court: Well, I'll take a recess at this time.

Mr. Marcus: Would your Honor instruct him not to discuss his testimony when he leaves the stand until I have an opportunity to complete the cross-examination.

The Court: I will talk to Mr. Ely here and then we will go on.

(A pause.)

The Court: Go ahead.

Q. (By Mr. Marcus): Mr. Ramirez, as I understand your testimony is now that without refreshing your memory with respect to the events that occurred on October 2, 1955, you were able to testify from your memory?

A. Are you referring to specific events?

Q. I am referring to what transpired on October 2nd. You testified concerning a cream-colored automobile, concerning other events with one Villas. You testified that you did not need to refresh your memory from the written record that you claim that you have upstairs in your office, as to those events?

A. That is right.

Q. Am I able to gather from your testimony now that you have an independent recollection as to what occurred on October 2nd, 1955?

A. As to those events you mentioned, yes. [158]

Q. As to those events I mentioned. And you have a definite recollection with respect to conversations you had on that date; is that correct?

A. Not particular conversations, no.

(Testimony of Jose Ramirez.)

Q. Well, you testified yesterday from the witness stand that you had a conversation with Johnny Villas on October 2nd; do you recollect that?

A. No, sir; I don't.

Q. Didn't you testify that you met Villas out in West Whittier on October 2nd? A. Yes, sir.

Q. Do you remember now testifying to that?

A. To meeting him, yes.

Q. That is what I said, to meeting him?

A. No; you said "conversation."

Q. You had to have conversation with him to meet him. You met him out there? A. Yes.

Q. You remember your testimony yesterday even, didn't you? A. Yes, sir.

Q. And you had conversation with Villas at that time, didn't you? A. Yes, sir.

Q. With respect to that conversation are you able to [159] give it to us at this time without reference to any notes or memoranda? Yes or no.

A. Partial conversations, yes.

Q. You looked at it yesterday, didn't you?

A. No, sir.

Q. Didn't you examine the notes yesterday concerning events that occurred on October 2, 1955?

A. Only to the car.

Q. I am asking you if you didn't look at the notes? A. Only to the car.

Q. Did you look at the notes? Answer my question. A. What notes, sir?

Q. Didn't you tell us a moment ago that you made a written memorandum of the events that oc-

(Testimony of Jose Ramirez.)

curring on October 2nd? A. Yes, sir.

Q. Were you required to look at those notes yesterday in order to be able to testify today?

A. No, sir.

Q. Then you have an independent recollection, your memory serves you to the extent that you recollect what transpired on October 2nd; is that correct? A. Yes, sir.

Q. Without reference to any written memorandum or notation that you made at the time, sir?

A. Yes, sir. [160]

Q. All right. Now, you tell this court where you were on February 5th of this year.

A. I do not recall.

Q. Tell the court with whom you had conversation on February 5th of this year.

A. I do not recall.

Q. You mentioned the Rubio case yesterday, didn't you? A. Yes.

Q. Do you have a recollection of testifying in court at Calexico?

A. I have never been in Calexico.

Q. Where did you testify in court with reference to the Rubio case?

A. I have not testified to the Rubio case.

Q. Didn't you testify yesterday that you were the investigator on that case?

A. No, sir. I assisted in the case.

Q. Well, you assisted in what?

A. In the case, in the Rubio case.

(Testimony of Jose Ramirez.)

Q. In what way did you assist in the Rubio case? A. Surveillance.

Q. Where did this case take place—where did the facts develop on that case?

A. East Los Angeles.

Q. What day did you make the surveillance of that case? [161] A. I do not recall.

Q. Was that this year? A. Yes, sir.

Q. And you don't remember the date that occurred and you conducted the surveillance on it; is that right? A. That is right.

Q. You have a written memorandum of that case, haven't you? A. Yes, sir.

Q. And without reference to the date you are unable to testify? A. That is right.

Q. How long ago did it take place?

A. It took place in June.

Q. In June? A. Yes.

Q. Last month? A. Yes.

Q. And yet you come into this court and tell the court the substance of conversation with reference to a cream-colored automobile that occurred on October 2, 1955?

A. No, sir; I did not testify to that.

Q. You didn't testify to that? A. No.

Q. You didn't testify to a cream-colored automobile [162] passing your car on October 2, 1955?

A. Yes, sir.

Q. Isn't that what I asked you a moment ago?

A. No, sir; you said "conversation."

Q. You testified yesterday concerning conversa-

(Testimony of Jose Ramirez.)

tion you had with Villas on October 2 in West Whittier, didn't you?

A. Not the contents of the conversation; no, sir.

Q. Maybe you don't remember what you testified to yesterday, do you? Do you remember what you testified to yesterday? Just yes or no, please.

A. Yes, sir; I recall.

Q. I will ask you right now. A. Yes, sir.

Q. Do you remember what you said yesterday on this witness stand?

A. In regard to what?

Q. What you said in regard to everything, all your testimony—do you recall what you said?

A. I recollect part of my testimony.

Q. Part of your testimony? Do you recollect all that you said on this witness stand under oath yesterday? A. No, sir.

Q. And you tell us you remember what happened last October 2nd when you don't even remember what you testified to on this witness stand yesterday; is that right? [163]

Mr. Bender: Your Honor, the Government—

Mr. Marcus: That is all.

The Court: Do you want to ask him a few more questions?

Mr. Bender: Just one question, I believe.

(Testimony of Jose Ramirez.)

Redirect Examination

By Mr. Bender:

Q. Mr. Ramirez, any reference that counsel made to October 5, 1955, was that the date that you observed the 1941 Chevrolet?

Mr. Marcus: Counsel, he corrected me every time I said the 5th; he said the 2nd.

Mr. Bender: I want to make certain that on those questions and answers he meant October 2nd.

Mr. Marcus: Well, he corrected me every time by saying October 2nd.

Mr. Bender: Well, if he did, I don't recall the correction.

Mr. Marcus: That is correct.

Mr. Bender: No further questions of this witness.

Mr. Marcus: May this witness remain here, your Honor? May he be instructed not to converse with any of the other witnesses before they testify as to what he has testified on the stand?

The Court: Yes; we have all the witnesses excluded; so you are not to discuss your testimony with any of the other [164] witnesses.

The Witness: Yes, sir.

The Court: So don't discuss it with any of the other witnesses.

The Witness: Well, there are some matters I have to take care of.

(Testimony of Jose Ramirez.)

The Court: Well, you may talk with the attorney.

The Witness: I mean out on the street, sir.

The Court: Well——

Mr. Bender: Your Honor, this man is presently engaged in his practice and profession of being a Federal Narcotics Agent.

Mr. Marcus: About this case is all I want.

The Court: He doesn't want you to talk about this case, that's all.

Mr. Marcus: Concerning his testimony; that is all I limit it to.

The Court: That is all.

Mr. Bender: What is the full scope of that instruction?

The Court: Well, in other words——

Mr. Bender: To whom does it apply?

The Court: At Mr. Marcus' request, I excluded the witnesses. Then you asked that it apply to the defense witnesses. So I have excluded the witnesses. All Mr. Marcus wants now that he is leaving the witness stand, he doesn't want [165] him to tell the other witnesses what he has testified to.

Isn't that your thought?

Mr. Marcus: That is exactly it.

The Court: In other words, we want everybody to tell their own story and not be coaching any other witness.

Mr. Bender: Where does that end?

The Court: It ends when he leaves the witness stand.

(Testimony of Jose Ramirez.)

Mr. Bender: I object with reference to Mr. Marcus telling the other witnesses for the defendant Lozoya what this man testified to.

The Court: Well, if you get into all those things—it is just the witnesses. The attorneys are in a different situation. This rule applies to the witnesses in the case, and I made the ruling that any witness who was to testify here had to leave the courtroom, and we even had the wife of the defendant leave because it was questionable whether she would be a witness. So Mr. Marcus instructed her that she would have to go also. She didn't want to go. The purpose of excluding witnesses is so that they won't talk to one another.

Mr. Bender: I want to make it crystal clear in my own mind that it is permissible for me to discuss this case.

The Court: Certainly. You are entirely different. You are not a witness. I said witnesses.

Mr. Bender: Thank you.

The Court: Do you have another witness? [166]

Mr. Bender: I have to get him out of the other room. He was excluded, of course.

The Witness: Does that mean that I am confined to this courtroom?

The Court: Why don't we let him go and have him come back at 2:00 o'clock?

Mr. Bender: That presents another problem, in any event.

The Court: I don't know why I should become——

(Testimony of Jose Ramirez.)

Mr. Marcus: This witness is confusing matters here. The only instruction is that he not discuss his testimony with other witnesses. There is no restraint on his going out for lunch or talking to them or anything, but not to discuss his testimony in this case.

The Witness: Very well. That is clear enough.

Mr. Marcus: That is perfectly proper.

Mr. Bender: That is clear, your Honor. I understood that he asked that he remain, and that would bring up the further question as to whether he could take the stand again in rebuttal, having heard the testimony.

Mr. Marcus: He is the investigating officer. He has a right to remain with you and take the stand in rebuttal, counsel.

The Court: This happens every day.

All right.

(A recess.) [167]

Mr. Bender: The Government calls as its next witness Mr. Goodman.

Mr. Marcus: Your Honor, in the interests of time, I would be willing to stipulate that his testimony would be substantially to the same force and effect as the other witness.

Mr. Bender: It won't be in all particulars, your Honor.

The Court: All right.

MEYER I. GOODMAN

called as a witness for the plaintiff, being first duly sworn, was examined and testified as follows:

The Clerk: State your full name, please.

The Witness: Meyer I. Goodman.

Direct Examination

By Mr. Bender:

Q. Mr. Goodman, what is your present profession or occupation?

A. I am an agent of the Bureau of Narcotics, the United States Treasury Department.

Q. For how long have you been so employed or engaged?

A. Well, throughout the United States for the past 17 years.

Q. Are you a graduate of a college of pharmacy?

A. Yes; I am.

Q. When did you graduate? [168]

A. I graduated from the Massachusetts College of Pharmacy in 1936 and continued graduate studies there for two years afterward.

Q. After you continued graduate studies, were you in any way connected with the field of chemistry? A. Yes; I was.

Q. In what manner?

A. I was a teacher and instructor of chemistry for approximately two years, and including chemistry, pharmaceutical chemistry, analytical chemistry, all the other phases and connected and related sciences in connection with my work. 7

(Testimony of Meyer I. Goodman.)

Q. In connection with your background as a chemist, have you had an opportunity to make analyses of the chemical content of narcotic drugs?

A. I might answer that to say that most of my examinations, and I would say they were probably over a thousand different occasions, have I examined physically—not chemically. That was the job of the chemist, actually. But physically the examination of it: Appearance, texture, odor, color; I have become very familiar, I would say, with the marijuana plant and——

Q. And with your experience as being a chemist, is a physical analysis one of the methods of ascertaining the chemical content of a substance— [169] strike the word “chemical”—whether a substance is marijuana or not?

A. Yes; it is, very often, prior to its submission to the chemist for final chemical analysis; usually in all cases it is examined physically for appearance, texture and identification.

Q. Then would a chemist also employ the physical analysis of the material?

A. Oh, yes; all the time before he conducts his chemical analysis.

Q. Then is the purpose of the chemical analysis merely to confirm his physical analysis?

A. That is exactly so.

Q. Directing your attention to on or about May 17, 1956, at approximately 7:00 o'clock in the evening or a little later, were you at that time and on that date in the vicinity of the Beverly Ranch

(Testimony of Meyer I. Goodman.)

Market in Montebello, California? A. I was.

Q. Was anyone with you at the time?

A. Yes. Agent Cantu, of our Bureau of Narcotics, and Agent Miller were with me directly across the street from the Ranch Market.

Q. Where were you located—in other words, was it——

A. We were located in a service gas station—I believe it was a 76 station, although I didn't pay particular [170] notice of that—near the parking area of the gas station. We were outside of Agent Cantu's government vehicle, and we had the hood open of the car and were allegedly examining the motor of the car.

Q. Before this time, in other words, before May 17th, at 7:00 o'clock, had you been shown any pictures by Agent Ramirez?

A. I believe Ramirez showed me a picture of the defendant Lozoya.

Mr. Marcus: I move that that be stricken, your Honor.

The Court: That may go out.

Q. (By Mr. Bender): What did Ramirez show you?

A. He showed me the photograph of an individual.

Q. Had you ever seen that individual before?

A. I never had; no, sir.

Q. Is that individual present in court today?

A. Yes, sir.

Q. Who is he?

(Testimony of Meyer I. Goodman.)

A. He is the defendant here, this gentleman here, with the glasses on, behind the—with the light shirt on.

Mr. Bender: Mr. Lozoya, will you stand, please?

(The defendant stands.)

Q. (By Mr. Bender): Is this the man you mean? A. That is the man.

Q. Directing your attention now back to May 17th, [171] some time after 7:00 o'clock in the evening, what occurred at that time?

A. At that time Agent Cantu and several other officers and I went to the vicinity of the Beverly Ranch Market and we drove into the gas station, as I said. directly across the street from the parking lot of the market, and at about 7:30 or so—well, Agent Ramirez was across the street parked in a government vehicle, in a car, in his government car, and was just sitting there, and at about 7:30 I saw the defendant, Mr. Lozoya, drive into the parking lot in a, I believe it was a 1940 Chevrolet sedan, which had previously been described to me, and stopped his car in front of the one in which Agent Ramirez was seated. I saw the defendant Lozoya get out of his car and walk over between the space where his car was and where Ramirez was, and Ramirez got out of his car and they spoke together for a moment.

I then saw Lozoya get back into his car and back it into a parking space directly next to Agent Ra-

(Testimony of Meyer I. Goodman.)

mirez' car. He then got out of the car again and there was a brief conversation further.

I then saw Lozoya go to the trunk of the Chevrolet he had driven and open it and take a burlap sack out of the trunk of the car. I then saw him transfer the burlap sack to the trunk of Agent Ramirez' car.

Ramirez, in the meantime, had walked over and opened the [172] trunk of the black Mercury, and at that moment when the transfer was made, I and several other officers ran up to the defendant, identified ourselves to him and told him he was under arrest.

I then had a conversation with the defendant at that time, at that place.

Q. What was said? A. I asked him——

Q. The defendant Lozoya?

A. The defendant Lozoya—I asked him where he had obtained the burlap sack containing the marijuana, and he replied, “I don't know what you are talking about.”

And I again asked him the same question, “I'm talking about the burlap sack that you just transferred from the trunk of your car to the trunk of the government car,” and he said, “You're mistaken. I didn't take anything out of the trunk of my car.”

I said, “I'm not mistaken. I saw you just take the sack out of your car.”

He said, “What sack are you talking about?”

My exact words at that time were—I said to Ra-

(Testimony of Meyer I. Goodman.)

mirez, "Open the trunk of that black Mercury and get the God damn sack out." And with that we took the—I think it was Agent Gullen and I reached over and pulled the sack out of the trunk of the Mercury and held it for a moment, and I said, [173] "This is the sack I am talking about."

Q. To whom did you say that?

A. I said that to Lozoya.

Q. How far was he from you?

A. He was standing right beside me.

And he said, "I don't know what you're talking about. I never saw that sack before."

After that, we then took him to the Federal Building. We had no further conversation—I didn't have any further conversation with him.

Q. You say that the defendant Lozoya was taken to the Federal Building. Was he actually in your custody on the way to the Federal Building?

A. No, sir; he was in the custody of—he got into the car driven by Agent Gullen and I think Agent Miller took him to the building, whereas I took custody, together with Ramirez, we both got into the black Mercury sedan with the sack of marijuana and went to the Federal Building behind the defendant.

Q. At the Federal Building did you make any inspection or examination of the sack which you testified you saw the defendant Lozoya remove?

A. Yes; when we got the burlap sack upstairs to the office of the Bureau of Narcotics, I removed the paper bags, opened several of them and ex-

(Testimony of Meyer I. Goodman.)

amined the contents. They had [174] different weights. We weighed a number of them at that time preliminarily on the scales that were in the room and examined the contents, and found them to be the material which is well known to me as marijuana.

Mr. Marcus: Just a moment. May that be stricken on the grounds, first, that it is nonresponsive, and, second, there is no foundation for the receipt of that evidence, your Honor?

Mr. Bender: Your Honor, so far as the ground of being nonresponsive, in the Federal Court in a case Judge Mathes ruled on, 106 Fed. Supp., I believe it is the Schneiderman case, the objection that it is not responsive is not a proper objection except by the attorney asking the question.

The Court: I will overrule the objection.

Q. (By Mr. Bender): Mr. Goodman, did you examine the contents of the paper sacks that you say were contained in the burlap bag?

A. I did.

Q. Which you took, which was in the Federal Narcotics office on or about May 17, 1956?

A. I did.

Q. Do you have an opinion concerning what substance was contained in these paper sacks?

Mr. Marcus: That calls for only a yes or no answer.

The Witness: I do. [175]

Mr. Marcus: I object to the question, now on the grounds that there is no foundation for his opinion.

(Testimony of Meyer I. Goodman.)

Mr. Bender: Your Honor, this man has testified that he graduated from a college.

Mr. Marcus: I understand what he has testified to, but he has not laid the foundation yet with respect to his qualifications to pass upon the substance. He has only testified that he gave it a physical examination by looking at it. I don't even know that he has testified that he gave it a microscopic examination, which is part of the physical examination.

The Court: I will overrule the objection. I'll let him testify.

Mr. Marcus: I understand that that will simply go to the weight?

The Court: That is right.

Q. (By Mr. Bender): In your opinion, Mr. Goodman, what substance was contained in the paper sacks that we have been discussing?

A. In my opinion, the substance is marijuana.

Mr. Marcus: I move, for the purpose of the record, that it be stricken on the grounds that there is no proper foundation, your Honor.

Q. (By Mr. Bender): What examination——

The Court: All right. [176]

Mr. Bender: Excuse me.

The Court: Go ahead.

Q. (By Mr. Bender): Upon what do you base this opinion?

A. I base this upon the physical examination, the odor, the texture, the color of the leaf, the shape and the type of leaf that marijuana is known to

(Testimony of Meyer I. Goodman.)

have, and the comparison of this material with a very great number of other samples of known marijuana that I have been in contact with during the past 17 years.

Q. Did you also rely upon your education and training?

A. Yes, sir. All these factors taken together.

Mr. Bender: You may cross-examine.

Cross-Examination

By Mr. Marcus:

Q. Did you ever testify in court as an expert forensic chemist?

Mr. Bender: Excuse me, your Honor, and counsel. I have one or two further questions.

The Court: All right.

Direct Examination

(Resumed)

By Mr. Bender:

Q. Mr. Goodman, I direct your attention to Government's Exhibit 1-B for identification—that is the large carton paper container, and in particular to Government's Exhibit 1 for identification, which consists of a burlap sack and various [177] paper sacks and their contents, and ask you if you have seen them before? The question relates to Government's Exhibit 1 for identification only.

A. Yes; my initials are on here—M.I.G.

Q. On where?

(Testimony of Meyer I. Goodman.)

A. On the paper sacks. Here they are again—
M.I.G.

Q. At the time you placed your initials on the paper sacks, did the paper sacks contain any substance? A. Pardon.

Q. At the time you placed your initials on the paper sacks, which are Government's Exhibit 1 for identification only, did those sacks contain any substance? A. Yes; they did.

Q. What substance, in your opinion, did they contain? A. They contained marijuana.

Q. Would you look into the paper sack at this time and tell us if the substance contained in them at the present time appears to resemble the substance which was contained in that paper sack at the time you placed your initials on them?

Mr. Marcus: I object to the question on the grounds that there has been no identification of this substance contained in these sacks here today to be the same substance he saw at that time.

Mr. Bender: I am asking him if it appeared to resemble.

Mr. Marcus: That it appeared to resemble is no probative [178] evidence. It certainly doesn't establish any corpus delicti. One piece of wood may resemble another, but that doesn't mean it is the same.

The Court: I'll overrule the objection. He may answer.

The Witness: This material resembles the same material that I saw on May 17th.

Q. (By Mr. Bender): I notice that when you

(Testimony of Meyer I. Goodman.)

were looking at it just now you appeared to sniff at, look at it. In your present opinion is the material contained in Government's Exhibit 1, the paper sack you looked at, is it a narcotic? Is it marijuana? A. It is.

Mr. Bender: At this time, the Government moves to introduce in evidence Government's Exhibits 1-A, 1-B and 1 for identification only as Government's Exhibits 1-A, 1-B and 1.

Mr. Marcus: Well, will your Honor reserve ruling respecting the receipt of this until I cross-examine the witness?

The Court: All right; the court will reserve the ruling.

Mr. Bender: That is all.

Cross-Examination

By Mr. Marcus:

Q. I understand, sir, that you went to a pharmacy school? A. That is right.

Q. What pharmacy school did you go to? [179]

A. Massachusetts.

Q. What is the name of the school?

A. Massachusetts College of Pharmacy.

Q. What pre-education did you have prior to going to Massachusetts School of Pharmacy?

A. The usual high school, elementary school and so forth.

Q. Did you graduate from high school?

A. Of course. That is one of the requirements.

(Testimony of Meyer I. Goodman.)

Q. What high school did you graduate from?

A. From the Dorchester High School.

Q. Then you went directly from high school to this pharmacy school? A. That is correct.

Q. What year was that? A. 1936.

Q. And you attended pharmacy school for how long?

A. I entered in '32. I graduated in '36.

Q. As a pharmacist, is that correct?

A. That is correct.

Q. Did you graduate as a forensic chemist?

A. There is no such thing as a graduate in forensic chemistry.

Q. My question is, did you graduate as a forensic chemist? [180] A. There is no such thing.

Q. There is no such thing as a forensic chemist?

A. Nobody graduates as a forensic chemist.

Q. You know what a forensic chemist is?

A. Yes.

Q. What is a forensic chemist, in your opinion?

A. A chemist.

Q. That is your understanding of the term "forensic chemist"? A. That is true.

Q. That he is a chemist? A. Yes.

Q. Isn't it a fact that a forensic chemist is entirely different from the ordinary chemist?

A. Well, there is a slight difference. A forensic chemist is familiar with certain other materials, that's all.

Q. Just a moment. My question is, is there not

(Testimony of Meyer I. Goodman.)

an entirely different distinction between a forensic chemist and an ordinary chemist?

A. Not entirely different, no.

Q. Did you graduate as a chemist even? Yes or no?

A. The term is "pharmacist."

Q. Please answer my question? Did you graduate as a chemist?

A. Well, it can be answered yes and no. [181]

Q. You graduated as a pharmacist, didn't you?

Mr. Bender: Your Honor, the Government interposes the request that the witness be permitted to explain his answer. He says he can't answer yes or no.

The Court: All right, let him explain.

Q. (By Mr. Marcus): My question is, did you graduate as a chemist?

A. Yes and no. I cannot answer.

Q. What was your degree when you graduated?

A. Bachelor of Science.

Q. What is the degree of a chemist, when a person graduates as a chemist?

A. Bachelor of Science.

Q. Bachelor of Science? A. Sure.

Q. As I understand, you were an instructor in pharmacy? A. And chemistry.

Q. For two years?

A. About two years, roughly.

Q. What school?

A. For awhile at the Massachusetts College of Pharmacy, in the Department of Chemistry, in organic and general chemistry, and then about an

(Testimony of Meyer I. Goodman.)

additional year at the Middlesex University, at Waltham, Massachusetts. After that I instructed in chemistry and materia medica at the Nurses Training School [182] at the Medfield State Hospital, at Medfield, Massachusetts.

Q. Let's start at this Nurses Training School in Medfield, Massachusetts, sir?

A. That's right.

Mr. Marcus: Could you remove this box, because I can't see this witness' features.

The Court: Yes. Put it there in the jury box.

Q. (By Mr. Marcus): Did you instruct at the Medford School of Nurses? A. Medfield.

Q. Medfield School of Nursing, on marijuana?

A. No, of course not.

Q. When you instructed at the other school, did you instruct on marijuana?

A. My entire——

Q. Did you instruct on marijuana? Yes or no?

A. Not at those schools; only when I was with the Bureau of Narcotics.

Q. We will come to that, please. In your training as a pharmacist, did you instruct on the subject of marijuana?

A. Yes, in training as a pharmacist at the College of Pharmacy, one of my lessons to my class was the identification and the appearance of the cannabis plant.

Mr. Marcus: All right.

The Court: Just a moment. [183]

(An interruption.)

(Testimony of Meyer I. Goodman.)

Q. (By Mr. Marcus): Mr. Goodman, as I understand, sir, the only thing you did at the time was to look at the package?

A. To look at the contents, smell it, examine its texture and so forth—physical examination.

Q. Yes, sir. And I understood you to say that the texture of the leaf—

A. The leaf, the stalk, the seeds, all very important to the identification.

Q. And based upon that examination you are of the opinion that it was marijuana?

A. Yes, sir.

Q. What does marijuana resemble, what other plant?

A. I don't think it—I think it is very distinctive.

Q. It resembles no other plant; is that right?

A. In my opinion, it doesn't. It is a very distinctive plant.

Q. It has very distinct characteristics of its own and it doesn't resemble any other plant; is that correct? Is that your opinion?

A. It is very distinct from all others, in my opinion.

Q. You didn't even look at it through a microscope, did you? A. No, I didn't. [184]

Q. That is a physical examination, too, with the microscope—the microscopic examination?

A. That is usually done by the chemist.

Q. You were able to tell the texture of the leaves by physical observation?

(Testimony of Meyer I. Goodman.)

A. From comparing it with many other examinations.

Q. I didn't ask you about comparing it with something else, because you didn't compare it at that time with anything else, did you?

A. With my memory.

Q. With your memory? A. Yes.

Q. But my question is, you didn't compare it at that time with any other leaf of known variety of marijuana, did you? A. I did not.

Q. You just looked at it, didn't you?

A. That is correct.

Q. And you could tell from the leaf, the texture of the leaf at the time that it was marijuana; is that right?

A. It was my opinion that it was.

Q. Are you sure of it?

A. Of my opinion?

Q. Are you sure that it was marijuana?

A. Yes, I am sure. [185]

Q. I am going to put this out here in front of the Judge. I'll just take it out at random out of this sack, and you show the Judge here how you examined the texture of the leaf by just looking at it?

A. You see these seeds?

Q. I see the seeds. I'm not talking——

A. Didn't you ask me a question, sir?

Q. I asked you to examine it——

A. Will you permit me to answer it?

Q. You just listen to me. I'm asking these ques-

(Testimony of Meyer I. Goodman.)

tions. You show the Judge the texture of the leaf that you examined in the marijuana?

A. The leaf in its fresh, new form has a certain characteristic. But the way we seize marijuana, and I have been at a number, oh, hundreds of seizures, this is exactly the way it appears in all cases, with the tiny seeds, your Honor, attached to the stalk. When you just shake it, you can see the seeds——

Q. Where are the seeds? Let's not get into any discussion about it. I want you to show the Judge——

Mr. Bender: You asked him.

The Court: Well, wait just a minute. I don't want the marijuana seeds on the court's bench. I am going to get it off of here right away. I don't want to be charged with possession. [186]

Q. (By Mr. Marcus): I want you to show the court the texture of the leaf that you say you examined at the time. A. Did you smell it?

Q. I'm not talking about the smell.

A. The odor is one of the most characteristic things. That's what I am trying to tell you.

Q. I'm trying to tell you that you testified before that you examined the texture of the leaf. Do you see any texture of any leaf?

A. Well, if it was an original leaf——

Q. Oh, let's not get argumentative at this moment. I'm asking you do you see any texture of any leaf on that piece of paper? Yes or no?

A. I can answer you that in my experience that

(Testimony of Meyer I. Goodman.)

is marijuana. That is the only way I can answer you.

Q. You see, I am testing what you know about marijuana.

A. I know a great deal about it, sir, I assure you.

Mr. Marcus: I move that be stricken, your Honor.

The Court: Yes.

Mr. Marcus: The Judge will pass upon your knowledge.

The Witness: I'm sure he will.

Q. (By Mr. Marcus): You testified that you examined the texture of the leaf.

A. The odor, the texture, the seeds, the appearance—everything about it. [187]

Q. Do you see any texture in any leaf there?

A. Will you explain what you mean?

Q. I'm asking the questions now.

A. I don't understand what you mean.

Q. You testified that you examined the texture of the leaf?

A. Yes, the feel of it.

Q. Do you see any leaf there?

A. This is a dried leaf, for your information.

Q. I understand. Isn't it in this same condition that it was in when you got it or saw it?

A. Identical.

Q. Do you see any texture of the leaves there?

A. Sure I do.

Q. Show the court where you see that texture of a leaf.

(Testimony of Meyer I. Goodman.)

A. Your opinion of a dried leaf and mine is different. This is all shriveled up. This is just the way it appears when we seize them.

Q. You don't see any texture of any leaf there at all, do you?

A. It is a matter of opinion what I see.

Q. Do you see any texture of any leaf?

A. This is a dried leaf.

Q. Answer my question.

A. I don't know what it is. [188]

Q. Do you see any texture of any leaf in front of you? Yes or no?

Mr. Bender: Just a moment. The Government objects to the question.

The Court: He may answer.

The Witness: You don't see a texture. As I understand it, the texture is the feel of something. You don't see texture.

Q. (By Mr. Marcus): Do you see any leaves there at all? A. Yes, I do, dried leaves.

Q. You see dried leaves?

A. That is right.

Q. Do you see any texture to those dried leaves?

Mr. Bender: What do you mean by "texture"?

The Witness: I don't understand what you mean by "texture."

Mr. Marcus: I'm not answering the questions. Please be seated.

Mr. Bender: The Judge advises the attorneys to be seated.

Mr. Marcus: Well, don't interfere with my examination. I don't have to answer your questions.

(Testimony of Meyer I. Goodman.)

The Court: Well, let's proceed.

Q. (By Mr. Marcus): Is this the same object that you saw on May 17th? Just yes or no?

A. This is identical with the object that I [189] saw.

Q. All right. Being a chemist, tell this court how many chemical tests you can subject this—
Withdraw that.

You being a chemist, tell this court what chemical analysis you can make of marijuana to determine for sure whether it is marijuana?

A. Oh, a number of tests can be made.

Q. How many?

A. I don't know how many. Probably at least four or five anyway that can be done. I don't conduct those, sir. I'm very sorry.

Q. You just name one chemical test?

A. Well, it can be submitted to—

Q. I know where it can be submitted. You tell me the name of the chemical test that you subject marijuana to, to determine whether or not it is marijuana?

A. There are a number of things that can be done.

Q. Can you give one?

Mr. Bender: I ask that the witness be permitted to finish his answer before counsel repeatedly interrupts, your Honor.

Q. (By Mr. Marcus): You just name one chemical test. Give me the name of it.

(Testimony of Meyer I. Goodman.)

A. One of them that can be done very rapidly is to add a little bit of diluted acid to it, you [190] see.

Q. Add a little bit of what?

A. Diluted acid.

Q. What acid?

A. A little hydrochloric, a little sulfur—won't make any difference. As a result of that, you see the leaf has tiny glandular hairs attached to the bottom of it.

Mr. Bender: Excuse me, your Honor——

Mr. Marcus: I'm asking the questions.

The Witness: I'm trying to answer.

Mr. Bender: The Government requests that counsel refrain from interrupting when he is answering the question.

Mr. Marcus: I asked him to state the name of a chemical test.

The Witness: I'm telling you.

Mr. Marcus: He claims to be an expert. I want him to name one chemical test.

The Witness: I do not conduct chemical tests. That is the job of the United States Chemist. But it just so happens that my training is the type that I have knowledge of these things, and I tell you that a diluted acid can be added to this material, when the diluted acid comes in contact with the carbonate which is deposited in the tiny hairs on the under-surface of these marijuana leaves, any individual can tell you that when diluted acid comes in con-

(Testimony of Meyer I. Goodman.)

tact with a carbonate carbon dioxide gas is emitted, which rises to the top in a [191] small bubbly appearance—that can be seen with the naked eye. That is one of the various significant tests of marijuana.

Q. Yes, but you never gave it that test?

A. No, I told you I never did.

Q. All right. Now you give me the common name that is used by a forensic chemist to test for marijuana—just give me the name of it?

A. Well, this is one of them.

Q. Well, what is the name of it?

A. The carbon dioxide test.

Q. The carbon dioxide test?

A. Yes, diluted acid test.

Q. As a matter of fact, you don't know what you're talking about; isn't that a fact?

A. I don't understand you.

Q. Isn't it a fact that you don't know what you're talking about when you say you administer hydrochloric acid to marijuana to get a test?

A. You asked if there were a number of tests. I said yes. This is one of them that can be performed. There are others. There are others with anil-alcohol, which gives a blue color test.

Q. What is it? Wait a minute now. What is it? Amyl alcohol? [192]

A. Yes, amyl alcohol is used sometimes.

Q. Amyl alcohol. What else?

A. There are other chemical names that I'm not familiar with because I don't conduct chemical tests.

(Testimony of Meyer I. Goodman.)

Q. As a matter of fact, Mr. Goodman, you have never conducted a chemical test to ascertain whether or not a substance is marijuana?

A. Yes, I have.

Q. What tests?

A. Back in New York we conducted chemical——

Q. What tests?

A. The sulfuric acid test.

Q. The sulfuric acid test?

A. The hydrochloric acid test. We take a little marijuana sample, put it under a cover slip of under a microscope, and a drop or two of hydrochloric, sulfuric, acetic, any acid. When they come in contact with the leaves, they liberate carbon dioxide from the carbonate which is deposited and it can be seen with the naked eye. I have done that many times.

Q. I understand you to say, sir, that there is a little hairy substance on the leaf of this marijuana?

A. On the under side.

Q. And it can be only ascertained microscopically; isn't that right? Didn't you just say that a minute ago? [193]

A. I didn't say it can only be ascertained; that's the usual way to ascertain it. It's too small to see with the naked eye.

Q. Well, if it's too small to see with the naked eye, tell this court how you're going to see it without looking at it with a microscope?

A. The hair you mean?

(Testimony of Meyer I. Goodman.)

Q. Yes.

A. You can't see it without a microscope.

Q. You can't see it without a microscope, and that is called a microscopic examination?

A. Yes. The microscopic examination is for the examination of the leaf and the hair. That is true.

Q. Have you ever testified in court as an expert forensic chemist?

A. I have testified as an expert in narcotics for the Government.

Q. My question wasn't whether——

A. No, I never have.

Q. ——whether you testified as an expert in narcotics for the Government. My question is whether or not you ever testified in court as an expert forensic chemist?

A. No, I never have, sir.

Q. I am going to ask you this question: Did you ever hear of the Duquenois test? [194]

A. I have heard of it.

Q. What is the Duquenois test?

A. I really don't recall offhand. I don't recall. I read it once—I read the method once.

Q. Where did you read it once?

A. In some of the material that were sent down from the United States Chemist at various times.

Q. Did you ever subject a substance that you believed was marijuana to the Duquenois test?

A. I was present when it was performed once.

Q. Do you have a recollection of the test that was performed under this so-called Duquenois test?

(Testimony of Meyer I. Goodman.)

A. Very vague. The United States Chemist could tell you about it.

Q. I know they could tell me very much about it.

A. Sure.

Q. Do you consider yourself to be a forensic chemist? A. Well, I am——

Q. Yes or no? Please don't argue.

Q. If you don't practice it, you are not a forensic chemist?

Q. If you don't practice it, you are not a forensic chemist?

A. I suppose you would say I am not.

Q. And a forensic chemist is a person who subjects these plants, these various organisms to different tests to ascertain [195] what their contents are; is that correct? A. Yes.

Q. So not being a forensic chemist, you, you wouldn't even know how to perform the Duquenois test, would you?

A. Oh, sure, very simple to perform it.

Q. You say you know how to perform the Duquenois test, do you?

A. Very, very simple thing.

Q. Answer the question. Yes or no?

A. Yes, I could perform it, positively. You could perform it.

Mr. Marcus: Will you mark this place in the record, Mr. Reporter.

Q. Tell us, now, how you would perform the Duquenois test.

A. I would go to the text book which had the

(Testimony of Meyer I. Goodman.)

directions to perform it, because any scientist or any chemist, anybody at all, would go to a reference for the directions in it, just like baking a cake, and you go ahead and do it and get the result you want. That's all.

Q. And you call yourself an expert by telling us you would go to a book on chemistry to find out how to do the test?

A. Any scientist goes to a reference, any good scientist goes to a reference before he goes ahead with it, sure. [196]

Q. Do you know these Duquenois tests are performed two, three, four, five times a day by the forensic chemist of the Sheriff's Office?

A. Of course, they do.

Q. You know that?

A. We don't do that. We have the United States Chemist for that. I'm trying to tell you that. That is not my job.

Q. Yes. You have the United States Chemist to ascertain whether or not the substances are marijuana or whether or not they are any other substance, don't you?

A. I thought that was stipulated.

Q. That was stipulated, but you took the stand to testify as an expert.

A. From appearance alone.

Q. Oh, now I understand you are only testifying from appearance alone? A. Yes.

Q. But you testified that in your opinion you were an expert chemist, didn't you?

(Testimony of Meyer I. Goodman.)

A. I am an expert for 17 years of narcotics and my training as a pharmacist.

Q. You are an expert because you say you looked at it and smelled it? A. Yes. [197]

Q. And therefore you are of the opinion that it is marijuana? A. Yes, sir.

Q. Why, before these matters, to your knowledge, are brought to court, the expert forensic chemists examine them and subject them to the Duquenois test, don't they? A. That's true.

Q. You never performed the Duquenois test in your life, did you?

A. I was present at the time a chemist performed several of them.

Q. Well, I was under the impression——

A. I never had the occasion to do it.

Q. All right, why don't you just answer without giving us a dissertation?

A. Well, that's what I'm trying to tell you.

Q. All right, what other tests are there, what other chemical tests are there to subject marijuana to?

A. There are others. I don't recall. I don't carry them in my mind.

Q. You see, I'm not asking you to guess, I'm testing your qualifications. I want to know if you know any other chemical test besides the Duquenois test. A. The Duquenois test——

Q. I'll tell you what they are in a minute. [198]

A. The Duquenois test I have heard of, the acid test, the carbonate test—those are all tests. There

(Testimony of Meyer I. Goodman.)

are probably others. I have heard of four or five. I don't remember them.

Q. Oh, you don't know any chemical tests, do you? Just be frank with us.

A. I am very frank with you, sir.

Q. You didn't even know there was such a thing as a Duquenois test, until I told you?

A. Well, I was present when a Duquenois test was conducted on a number of occasions by the chemist.

Q. Isn't it a fact that there are certain colors emitted when the substance that is marijuana goes through the Duquenois test?

A. That is a color test.

Q. Please answer the question.

A. Yes.

Q. Isn't it a fact that it goes through different tests? A. Yes.

Q. Now, taking it a step further, what other things are emitted when it goes through the Duquenois test?

A. I don't recall offhand. I would have to go to the reference.

Q. You don't know anything about the Duquenois test, do you? [199]

A. Where did you get your information about the Duquenois? You went to a reference, did you not?

Q. If you want to know, Mr. Goodman. I'll tell you. I've tried hundreds of these cases. I know the Duquenois test. I know the other tests that are in-

(Testimony of Meyer I. Goodman.)

volved, but I'm not going to tell you. If it will be of assistance to you, I'll tell you at some other time. Now, sir, are you testifying now that this is identically the same substance as you saw on May 17th?

A. This is identical in appearance—I only examined the appearance—to the substance that I saw on May 17th. That's all I'm trying to tell you.

Q. Is it the same substance that you examined on May 17th? A. It appears to be, yes.

Q. That isn't what I asked you.

A. That is all I can state, that it appears to be.

Q. Then you don't know, do you, that this is identically the same substance?

A. Well, this is the material that was in the bags that was mailed to the chemist by registered mail.

Q. You never mailed it, did you?

A. No, it was mailed by one of the other officers, probably Agent Ramirez.

Q. Now remember, you're under oath, you don't know [200] whether it was mailed or not, do you?

A. I believe it was.

Q. Now, let's get back to what happened on the night of May 17th. What time did you arrive there?

A. About 7:00 o'clock p.m., I would say.

Q. Who came along with you?

A. I was with one of the other officers. I think it was Miller. I am pretty sure it was Miller.

Q. Are you sure it was Miller? A. Yes.

Q. How did you arrive there at that time?

(Testimony of Meyer I. Goodman.)

A. In a car.

Q. What kind of a car did you drive in?

A. It was a Buick.

Q. A Buick automobile? A. Yes.

Q. What model? A. It was a 1954 Buick.

Q. Was it a sedan or a convertible?

A. It was a sedan.

Q. Was that a government car?

A. Yes, sir.

Q. Just the two of you came there together?

A. Just he and I. We met other officers there.

Q. You say you went into the service [201] station?

A. Yes, we drove into the parking area of the service station.

Q. This was across the street from where this large market was located, wasn't it?

A. That is right.

Q. Was it across the street from where the parking lot was? A. That is correct.

Q. How long did you wait there before you saw Agent Ramirez?

A. Agent Ramirez was there when we arrived. He was parked in his car.

Q. How long was it before you actually saw him there? A. A minute or two, I would say.

Q. Was he in his car or was he outside the car when you first saw him?

A. When I first saw him he was in the car.

Q. What was he doing at the time you saw him?

A. Sitting at the driver's wheel.

(Testimony of Meyer I. Goodman.)

Q. Was he doing anything besides sitting?

A. I don't recall him doing anything special. He might have been eating some fruit or something. I don't know.

Q. He might have been eating some fruit?

A. As I recall, he was eating some fruit.

Q. What kind of fruit was he eating? [202]

A. I don't remember. It was a piece of fruit of some kind.

Q. As a matter of fact, he was eating an apple, wasn't he?

A. He might have been, I don't know.

Q. And as a matter of fact he dropped the apple, didn't he? A. I don't remember.

Q. Didn't you have some discussion with Officer Ramirez before you went there that he was going to eat an apple and drop the apple?

A. He said something about that. I don't recall.

Q. Something about eating an apple?

A. Eating some fruit.

Q. Well, what kind of fruit?

A. Some fruit, an apple or a banana or something like that.

Q. Do you have any recollection of that fruit that he was supposed to eat?

A. I believe it was either an apple or a banana. That is my best recollection.

Q. That is your best memory? Was he actually eating an apple or a banana at the time?

A. He was eating something from where I was. I

(Testimony of Meyer I. Goodman.)

could see him eating something through the windshield. [203]

Q. It was so far away you couldn't tell what he was eating; is that correct?

A. I couldn't see what he was eating, no; just that he was eating something.

Q. Because of the distance and it was late, 7:30, somewhere about that time, wasn't it? Don't laugh at this. This isn't funny at all.

A. Of course, it isn't. I told you he was eating fruit. I couldn't distinguish what he was eating exactly.

Q. Did you have any prearranged plan with him that he was to eat any certain kind of fruit?

A. I think there was something said about that.

Q. Well, where was it said?

A. In the office, before we went out.

Q. Before you went out there?

A. Yes, before we went out there, something was said about it.

Q. With whom did you have the conversation?

A. With Ramirez.

Q. Was the conversation about any particular fruit?

A. I believe he mentioned a banana. I believe he mentioned a banana. I'm not——

Q. Was he eating a banana or was he eating an apple or was he eating a pear?

A. I told you I couldn't distinguish what the fruit was, [204] but he was eating something.

Q. Why couldn't you distinguish? What pre-

(Testimony of Meyer I. Goodman.)

vented you from telling what that fruit was? Was there any particular obstruction from your view?

A. Well, just that he was sitting inside a car at the time, and——

Q. Did he eat the fruit when he got out of the car, or did he leave the fruit on the seat?

A. I don't know what he did with it. He was eating fruit. He was eating something in the car.

Q. That is your best memory, what you have told us now, with respect to this fruit business; is that right? A. That is right.

Q. There is nothing else in addition to that that you remember now concerning fruit, whether it was an apple or a banana, or where he was eating it, whether he was eating it in the car or eating it outside; is that right?

A. That is to the best of my memory right now.

Q. Now, it was dark at the time in the evening, wasn't it? A. No.

Q. It was light? A. It was light.

Q. You could discern Mr. Ramirez's features, could you? A. Yes. [205]

Q. From where you were? A. Yes.

Q. Yet you couldn't see what was in his hand or what he was eating?

A. I couldn't tell what he was eating.

Q. As you were across the street there, how many officers were with you?

A. Agents Cantu and Miller; two officers were with me.

Q. There were just three of you across the

(Testimony of Meyer I. Goodman.)

street? A. That is right.

Q. Were there any other officers there besides?

A. Yes, there were two other officers on the other side of the street near the market, on the opposite side of the street near the market.

Q. Were there other cars parked on this lot?

A. There were several, yes.

Q. How many cars were parked there?

A. I would probably say perhaps four or five, maybe half a dozen, scattered in the parking lot.

Q. People were walking back and forth over the lot? A. Some of them, yes.

Q. The market was open, wasn't it?

A. Yes.

Q. This was one of those large supermarkets, is it not? A. Yes. [206]

Q. You were inside the station across the street, weren't you? A. No, sir.

Q. Were you on the sidewalk?

A. I was in the parking area standing beside the government car.

Q. Well, the parking area there on that station as distinguished from the sidewalk, is it not?

A. That is correct.

Q. So you were further away because you were not on the sidewalk?

A. Not on the sidewalk; just directly behind.

Q. And Beverly Boulevard is a wide boulevard, is it not? A. Fairly wide.

Q. How many feet?

A. I wouldn't know. Perhaps 30 or 40 feet.

(Testimony of Meyer I. Goodman.)

Q. 30 feet for Beverly Boulevard?

A. Possibly.

Q. Or 40 feet? A. Yes.

Q. Well, you know it is an 80 foot boulevard, don't you? A. It might be.

Q. It might be 80 feet?

A. I don't think it is 80 feet. I doubt it is that wide. [207]

Q. Did you see Mr. Lozoya over there?

A. Yes, when he arrived.

Q. Yes? A. Yes, I did.

Q. You saw him when he drove into the lot?

A. I saw the car drive in and he stepped out of the car.

Q. You saw his car drive in. Did you see him in the car as it drove in? A. Yes.

Q. Who else was there at the time?

A. Who else was where, with me or——

Q. Not with you. In that area where he drove in, who else did you see there?

A. There might have been other people. I was not particularly paying any attention, sir, to any other persons.

Q. This man was at least a hundred feet from you, wasn't he? A. That is correct.

Q. How far away was he from you?

A. About a hundred feet. That is a very good estimate, I would say.

Q. And you were able to discern his features at that time of night from where you were standing? A. I saw——

(Testimony of Meyer I. Goodman.)

Q. Were you able to discern his features at that time? [208]

A. Well, I saw this gentleman.

Q. Where you able to discern his features?

A. Do you mean to say the shape of his nose or the color of his eyes?

Q. Yes. Not the color of his eyes; discern his features. His eyes are not his features.

A. That is the gentleman I saw step from the car.

Q. You won't answer my question?

A. That is the only way I can answer the question.

Q. You saw a gentleman step from the opposite side from where you were standing, did you not?

A. No, he stepped from the driver's side of the car first, which was closest to me.

Q. Was there anybody else in his car at the time?

A. I didn't see anybody else.

Q. His car came in alone; he had no passengers?

A. I think there was somebody else with him at that time.

Q. Please don't guess.

A. Now that I recall, I think somebody was with him.

Q. A moment ago you said you thought he came in alone. You think somebody else was with him at the time?

A. I think somebody else was with him.

Q. Did you see anybody else get out of his car?

A. I believe somebody else did get out of his car. [209]

(Testimony of Meyer I. Goodman.)

Mr. Marcus: That is all.

The Court: Is that all for the witness?

Mr. Marcus: Well, a lot further examination, but it is 12:15 now.

The Court: Well, I thought maybe I would accommodate him and get through. I guess we better make it 2:00 o'clock. It is 12:15.

Mr. Bender: I think 2:00 o'clock is a good time. Of course, we will not finish today.

The Court: All right, 2:00 o'clock.

(Noon recess.) [210]

Wednesday, July 18, 1956—2:00 P.M.

Mr. Marcus: May I apologize to the court.

The Court: That's all right.

Mr. Marcus: I had to make an appearance in the Superior Court and the judge was late taking the bench.

The Court: I understand.

Mr. Marcus: Take the stand, please.

MEYER I. GOODMAN

called as a witness for the plaintiff, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination

(Continued)

By Mr. Marcus:

Q. Mr. Goodman, as I understand, sir, your opinion is that the matter or substance that you examined on May 17th or 18th of this year, in your opinion, was marijuana? A. Yes, sir.

Q. And you based your opinion at that time upon the fact that you were graduated from a school—— A. No, I didn't.

Q. ——as a pharmacist?

A. No, I did not.

Q. Well, that is part of it, isn't it?

A. Well, that is a very minor part of it. [211]

Q. A very minor part of it?

A. Yes. I based it on 17 years as a Narcotic Agent and examination of probably a thousand samples of marijuana, sir.

Q. Have you ever at any time tested, by virtue of the microscopic examinations, any substance that you believed was marijuana?

A. I believe I did, once or twice.

Q. Once or twice?

A. Probably back around 1940 or '41.

Q. Except for those two examinations that you believe you may have subjected a substance known as

(Testimony of Meyer I. Goodman.)

marijuana, have you performed any other test upon any substance that you believed was marijuana?

A. Yes.

Q. What tests have you subjected them to?

A. To the test in which a diluted acid was administered to the material and the observation of carbon dioxide gas escaping, and I was also present on several occasions when the United States Chemist and the State Chemist at various localities conducted the Duquenois test.

Q. The what test?

A. The Duquenois test, the one you mentioned. I was present when that was done.

Q. You say you have observed chemists apply hydrochloric [212] acid to a substance believed to be marijuana; is that correct?

A. Some diluted acid. It wouldn't have to be hydrochloric. Any diluted acid.

Q. Any diluted acid directly to the marijuana?

A. Well, it was probably macerated first in a little water, put it under a glass——

Q. Well, was that done, not probably.

A. I believe it was, on those times when I observed it.

Q. Well, what happened? How were you able to ascertain by the the test that you have explained that the substance is marijuana?

A. Well, the major portion of the identification took place by the examination of the crude material itself. The very distinctive odor of it.

Q. We'll pass that now.

(Testimony of Meyer I. Goodman.)

A. These are all supplemental.

Q. I'm asking how you determine by the chemical analysis test known as the Duquenois test whether the material is actually marijuana?

A. I never used the Duquenois test personally. That is the province of the U. S. Chemist to establish that the material was marijuana.

Q. But you stated that by applying hydrochloric acid or any acid directly to the substance, you can tell that the [213] substance is marijuana or is not marijuana?

A. That is one of the substantiating factors in the identification of it. That alone does not prove, one way or the other, but that added to all the other things is very substantial.

Q. Well, sir, am I to understand your testimony is now that even with the application of the Duquenois test you cannot tell whether a substance is marijuana?

A. No, I didn't say that.

Q. All right.

A. The Duquenois test is very conclusive. It is a specific chemical test used by the State Chemist, by the U. S. Chemist in all types of cases such as this, in positively identifying the material beyond any dispute.

Q. How do you tell whether the substance is marijuana when the Duquenois test is made?

A. Well, it is a color test. As I recall, the test being performed in my presence on a number of occasions, it's a test in which the Duquenois reagent, which is a combination of materials, a liquid sub-

(Testimony of Meyer I. Goodman.)

stance, the Duquenois reagent is added to the marijuana. Let's say we take a little marijuana——

Q. Please tell me how you tell after the test?

A. By the color test.

Q. What color does it take?

A. It takes a pale blue color. There is a little blue [214] line that is formed at the junction of the Duquenois reagent and I believe it is concentrated hydrochloric acid that are used.

Q. You believe that?

A. Yes, I'm just telling you from recollection now, from my memory. You see, they take the crude material——

Q. A blue color?

A. A pale blue color, yes, which is very specific. You see, if I may explain to you, sir, the crude material as we obtain it, such as this, first has to be treated with the Duquenois reagent. It is macerated—in other words, it is placed in a mortar and with his pestle it is ground up slightly with the Duquenois reagent and the Duquenois reagent acts with cannabinal, which is an alcohol type of material in the plant and extracts the cannabinal. Then they filter this material off and they obtain a clear liquid containing the cannabis or marijuana. It is then treated with concentrated hydrochloric acid solution, which, if the material is marijuana, forms a distinct blue line at the meeting of these two liquid materials. That is to my best recollection. I may be slightly mistaken in possibly one of the materials, but that is the general conception that I have.

(Testimony of Meyer I. Goodman.)

Q. Isn't it a fact that there is no blue line formed at all and that isn't the color at all?

A. That is not a fact. I have seen the blue line form. [215]

Q. Isn't it a fact that it is a bright purple color?

A. No, it is not a bright purple color. As I recall, it is a distinct blue color.

Q. How many of those blue lines have you seen?

A. Oh, I've seen maybe a dozen or half a dozen—I don't recall—over the years.

Q. Have you any books you could refer to at the present time?

A. Not with me right here, but I could take you to any library and show it to you.

Q. I don't want you to show it to me, but I want you to convince yourself of it, if there is, as you say, a blue line that indicates to you that it is marijuana.

A. Yes.

Q. If it should turn out to be a purple line, what would that indicate to you?

A. That would indicate to me that there is considerable room for doubt.

Q. Do you have any books available to you now?

A. No, I don't. I believe the U. S. Chemist could provide them to you, sir.

Q. Do you know of any other chemical test?

A. Offhand I don't recall, to tell the truth. My work has been in the——

Q. Isn't the bean test another common way [216] of ascertaining the substance is marijuana?

A. The word is familiar to me. I haven't been

(Testimony of Meyer I. Goodman.)

associated with it for many years. I have heard the term used. There are a number of tests that can be used.

Q. Isn't it a fact that in the Duquenois test they do not use hydrochloric acid at all?

A. I believe concentrated hydrochloric acid, I said, is used.

Q. Hydrochloride, not hydrochloric, that is used?

A. I don't—

Mr. Bender: Just a moment. The Government objects to counsel's continuing to interrupt before the witness has finished his answer.

Mr. Marcus: I am sorry.

Mr. Bender: May he be permitted to finish his answer, your Honor?

The Court: Yes.

Q. (By Mr. Marcus): Is it hydrochloride acid that is used?

A. There is no such thing as hydrochloride acid.

Q. There is no such thing?

A. No. That is an incorrect term for you to use.

Q. I see. Now, did you ever hear of applying the bean test by using ethyl acetate as a solvent to the substance? Did you ever hear of that? [217]

A. I have heard of it. Well, that is very similar in many ways to the Duquenois test.

Q. This is called the "bean test." Have you ever heard of the bean test?

A. I think it is the "beam test."

Q. That's right.

A. You said "bean," as I heard it. ✓

(Testimony of Meyer I. Goodman.)

Q. All right.

A. I have heard the term used.

Q. Have you ever seen the test used?

A. A long time ago I might have. I don't know.

Q. Isn't it a fact that in the beam test the substance is burned?

A. I don't recall that it is.

Q. You don't know that?

A. I don't think it is.

Q. All right. We will proceed further now from these tests. You don't claim to be a forensic chemist, do you?

A. No, I do not. My work is as a Narcotics Agent for 17 years.

Q. Isn't it, sir, the most unreliable test to determine whether a substance is marijuana or not by visual examination?

A. That is one of the best, in my opinion, one of the best tests is by the sensory organs: by the odor, by the appearance, by the texture, and so forth. [218]

Q. By the appearance? The appearance, you mean the fuzzy substance?

A. The fuzzy material, the very characteristic seeds that are found always attached to the material, the very distinctive odor one obtains by rubbing it in the palm of the hands. Any officer can tell you that.

Q. In every one of these cases they are sent to the U. S. Chemist at San Francisco, aren't they?

A. Invariably, all of them.

(Testimony of Meyer I. Goodman.)

Q. And that is so that there shall be no doubt concerning the substance; isn't that correct?

A. Yes, very true.

Q. And the chemist, sir, performs the Duquenois test or the beam test, doesn't he?

A. I believe he does.

Q. And you insist that the mere visual examination is the best test?

A. The first thing a chemist does——

Q. Is that right? You insist the visual examination is the best test?

A. For a person in the field like myself, yes.

Q. I am talking about not whether you are in the field or not. I'm talking as to whether or not the test to be applied is more reliable by a mere visual examination than by a chemical analysis of the substance, in your opinion? [219]

A. The final judge is the chemical test.

Q. That is the best test, isn't it?

A. Yes, sure.

Q. And that is the most reliable?

A. Positively, I agree.

Q. And isn't it a fact that even when a microscopic examination of the substance is made you may err with respect to its nature or its kind?

A. That is quite possible.

Q. And the microscopic examination is more reliable than the mere visual examination, is it not?

A. In my opinion, they have about the same weight.

Q. In other words, if you look at a substance

(Testimony of Meyer I. Goodman.)

through the naked eye without the benefit of microscopic examination and you look at it through the microscope, in your opinion the visual examination by the microscope and through the eye has about the same weight; is that right?

A. About the same weight. They are both very important.

Q. That is your opinion?

A. That is my opinion.

Q. As a chemist? A. Yes, sir.

Q. Is this your first experience on the witness stand to testify, in your opinion, with respect to whether a substance is marijuana or not? [220]

A. I have testified as an expert witness on at least half a dozen occasions.

Q. I'm asking you, sir, if this is your first experience today on the witness stand wherein you are testifying with respect to your opinion on the subject of marijuana?

A. I told you I have testified at least on six occasions in six different courts, in probably six different parts of the United States.

Q. Did you ever testify in the District Court of California before? A. Yes, on other cases.

Q. With respect to your opinion as a chemist?

A. No, we always have the chemist here—always.

Q. Why don't you answer that directly that you have never testified before in the District Court of California with respect to——

A. I said no.

(Testimony of Meyer I. Goodman.)

Mr. Bender: Just a moment. The Government objects.

Mr. Marcus: I hadn't finished the question.

Q. My question is, sir, have you ever testified as an expert? A. No, I have not.

Q. In the District Court of the United States at Los Angeles? A. I have not. [221]

Q. Where have you testified as an expert?

A. In Massachusetts and in New York.

Q. In the United States District Court?

A. I think they were all in the state courts.

Q. Did you ever testify in any United States District Court as an expert chemist?

A. I believe I did once in New York, in the Southern District of New York.

Q. How long ago?

A. I believe it was in '42 or '43.

Q. You believe you did on one occasion; is that right, sir?

A. As I recall, in the District Court.

Q. Yes, that's what I'm talking about.

A. My best recollection. I don't remember.

Q. Are you even sure of having testified on one occasion? A. Yes, I'm sure of that.

Q. And in what District was that?

A. Southern District of New York, New York City.

Q. Do you recall the name of the case?

A. I don't recall, no.

Q. Were there chemists testifying in court at that time?

(Testimony of Meyer I. Goodman.)

A. No, that was another situation in which the material [222] had been stipulated and then through some misunderstanding——

Q. The material had been stipulated to being marijuana?

A. Yes, and then through some misunderstanding the question was raised by the defense, as I recall it, and a situation arose in which the United States Attorney placed me on the stand due to my long experience of observing this material.

Q. Similar to what has happened in this case?

A. Very, very similar.

Q. And I assume that you were not cross-examined as you were today? A. Yes, I was.

Q. You were? A. Yes.

Q. And since that time you didn't testify in any court after you came here?

A. We always have the chemist here, all of the time.

Q. On all other cases where you testified there has been a chemist who testified; is that right?

A. My position is as a Narcotic Agent, not as a chemist.

Q. I understand, but you have been called upon today as an expert.

A. Apparently for the reason that the chemist is not here.

Q. You don't consider yourself an expert forensic [223] chemist, do you?

(Testimony of Meyer I. Goodman.)

A. I consider myself an expert in the observation of narcotic drugs.

Q. Do you consider yourself an expert forensic chemist? A. No, not right now.

Q. That answers it. Now, sir, directing your attention to this day, May 17, 1956, have you related in direct examination everything that you now recollect as having occurred on Beverly Boulevard with reference to the defendant Lozoya?

A. I believe I have. I might have missed some minor point.

Q. Just in summation, did you so testify this morning that you were standing across the street, that you observed a car drive on the lot, that you saw the defendant Lozoya in the car, that you do not recollect at this time whether there was anyone else in the car with him or not, that the car came to a stop——

A. No, I recollect that there was somebody with him.

Q. Now, you are definite that there was someone with him?

A. I recollect somebody was in the car with him.

Q. Now, you say the car finally came to a stop parallel to the car which Mr. Ramirez had been sitting in? A. No, the first time—— [224]

Q. It finally came to a stop?

A. Eventually, yes.

Q. That is what I said

A. And backed in beside the car.

Q. That you saw Mr. Lozoya get out and have

(Testimony of Meyer I. Goodman.)

a conversation with Mr. Ramirez, and then proceed to open the trunk of his car, take a sack or something out of the car there and put it into the government car; did you say that?

A. Yes; I believe I did.

Q. And then you gentlemen ran across the street? A. That is right.

Q. Did you see Mr. Ramirez at any time have his hands on that substance or that sack?

A. At any time?

Q. There at that time while you gentlemen were across the street?

A. He might have touched it. I don't recall. He might have touched it in the process of transferring. I don't recall. I don't think he did touch it.

Q. Where was Mr. Ramirez at the time that Mr. Lozoya, as you claim, opened the trunk of his car and took the substance or whatever he had there and put it in the car which Mr. Ramirez had been in? Where was Mr. Ramirez at that time?

A. He was standing——

Q. He just stood there? [225]

A. Besides Lozoya.

Q. Did he move at any time?

A. Oh, yes; he moved.

Q. What did he do, if you observed him?

A. Just moved. He stood there and stood beside this gentleman.

Q. Tell us exactly what you remember at this time that you saw him do? A. Ramirez?

Q. Mr. Ramirez.

(Testimony of Meyer I. Goodman.)

A. He just stood there and watched Lozoya transfer the bag of marijuana from the back of Lozoya's car to the back of Ramirez's car.

Q. You didn't see Mr. Ramirez do anything, did you?

A. That is all he did, as far as I can recall.

Q. Just stood there?

A. Just stood there.

Q. You saw Mr. Ramirez's car before Mr. Lozoya walked up to it, didn't you? A. Yes.

Q. Had you seen it before?

A. Before Lozoya arrived?

Q. Before Lozoya arrived? A. Yes.

Q. Did you see it when the car arrived? [226]

A. When Lozoya arrived.

Q. No; when Mr. Ramirez arrived?

A. No; he was already there when I arrived. He was parked and sitting in the car.

Q. He was already parked and sitting in the car?

A. That is right.

Q. You didn't see Mr. Ramirez go up to the back of his car, did you?

A. At what time are you referring to?

Q. At any time while you observed him there, did he ever at any time, while you were there across the street observing Mr. Ramirez, see him go to the back of his car?

A. Well, when Lozoya arrived and took the sack out, Ramirez had to open the trunk of his car.

Q. Now you have the point.

(Testimony of Meyer I. Goodman.)

A. Maybe if you had mentioned it I would have understood what you are talking about.

Q. I asked you if you told us everything and you said you had. I asked you if you saw him do anything except watch Mr. Lozoya. Now you realize, don't you, that he would have to open the trunk of his car in order to put something in?

A. I believe on direct examination I told you that, sir.

Q. I'm asking you on cross-examination. I'm not conducting any direct examination. You understand that, don't [227] you, that he would have to open the trunk of his car? A. He certainly did.

Q. In order for something to get in there?

A. That is very true.

Q. Did you actually see him open the trunk of the car?

A. Yes; I saw the trunk fly open.

Q. And who opened it? A. Ramirez.

Q. Now you remember that?

A. Yes; I remember that.

Q. That comes to you since you have been prompted?

A. No; I misunderstood what you were driving at, sir.

Q. Did you see what he opened the back of the car with?

A. With a key, I assume. I couldn't see the key.

Q. But you saw him monkey with the lock?

A. He went to the back of the car at the time and the trunk opened.

(Testimony of Meyer I. Goodman.)

Q. You saw him open the trunk, and you saw Mr. Lozoya put the stuff in?

A. That is correct.

Q. And it was never removed, was it, from the sack while you observed it during the time it came from Lozoya's car until the time it came to the Ramirez car? A. What was removed?

Q. Any of the substance? [228] A. No.

Q. Was it opened? A. No, sir.

Q. Or examined? A. No.

Q. You're sure of that? A. I am positive.

Q. Now Mr. Ramirez has testified that he, at the time that Mr. Lozoya took it out of his car, he took a package of it out and he opened it and he looked at it and examined it.

Mr. Bender: You have misstated his testimony in that regard.

Mr. Marcus: I have not. He said he opened the package and he looked at it and he asked him if it was good stuff or not.

Mr. Bender: He testified——

Mr. Marcus: Please, I'm suggesting to the court, make an objection.

Mr. Bender: All right. The objection is that you are asking a question based on evidence not in the record. Your statement concerning the purported statement of Mr. Ramirez is in error. It is incorrect.

Mr. Marcus: I will stand on the record and ask this witness whether or not you at any time saw Mr. Ramirez, from the time it was placed in his car, take

(Testimony of Meyer I. Goodman.)

the substance out and [229] open the package right then and there?

A. From the time Lozoya took the bag from the back of his car?

Q. Yes.

A. To the time it got into the rear of Ramirez' car?

Q. Yes.

A. I didn't observe him take the package out. It is possible he might have, but I didn't observe it.

Q. If you observed everything that happened, how could it be possible that he opened the package and looked at it?

A. Well, I didn't see him take a package out of there, no.

Q. Did you, after you arrived, open any packages? A. No; not on that scene there.

Q. Was the package opened at all while you were there? A. While I was there?

Q. Yes.

A. One of the other officers might have, but I didn't notice it.

Q. Not what they might have done. Did you at any time observe anyone open any of the packages there at the scene?

A. Well, you see, I was talking to Lozoya——

Q. Yes or no. I don't care whether you were talking to Lozoya. Did you observe anybody open any package? [230]

A. I didn't see it, no. It might have been done, but I didn't see it.

(Testimony of Meyer I. Goodman.)

Q. How long did this whole incident take?

A. Oh, about five or ten minutes.

Q. Do you think it took as long as ten minutes?

A. I don't know. A very short period of time.

Q. You walked over together with the officers with drawn guns, did you not? A. No, sir.

Q. Did anybody have their guns out?

A. I don't think so. I didn't have mine out. I was not interested in what the other officers were doing.

Q. You saw them there?

A. The other officers were accompanying me. Some were behind me. Some were in front of me.

Q. You didn't see whether or not they had their guns drawn?

A. I didn't notice. They might have.

Q. Before you walked across the street you didn't know what was in those packages or you didn't know at any time while you were there, did you?

Mr. Bender: That is objected to as being compound.

Q. (By Mr. Marcus): Did you at any time—
The Court: He is withdrawing it.

Q. (By Mr. Marcus): Did you at any time know, of your [231] own knowledge, what was in the sacks during the period of time that you were there?

A. No, not until I examined it later.

Q. I'm only talking about the time you were there. A. No.

Q. Listen to my question.

(Testimony of Meyer I. Goodman.)

A. Of course not. I say no.

Q. You didn't know what it was?

A. Positively no.

Q. You didn't even look at it, so you wouldn't know, by any chance, would you?

A. That is correct.

Q. Did you tell Mr. Lozoya he was under arrest?

A. I believe Agent Gullen told them, in my presence.

Q. Did you also tell Mr. Villas or anyone else tell Mr. Villas, in your presence, that he was under arrest?

A. Who is Mr. Villas?

Q. Did you see anybody else there that evening?

A. There was another fellow called Johnny, by Agent Ramirez. I didn't know him particularly.

Q. Let's say Johnny then. Did anyone tell Johnny that he was under arrest?

A. One of the officers might have. I don't recall.

Q. Did you actually hear them say it?

A. No, I didn't [232]

Q. Is it a fact, sir, that when you walked up there you said to Mr. Ramirez, "Where is the stuff"?

A. That is not so.

Q. Not so.

A. No. I saw him put it into the trunk of the car.

Q. I understand that is what you testified to. Did you examine Mr. Ramirez' car—I mean Mr. Lozoya's car?

A. I did.

Q. You did? A. Yes.

Q. What examination did you make of his car?

A. I asked him for his keys.

(Testimony of Meyer I. Goodman.)

Q. Yes, sir.

A. And I think the keys were still in the ignition, as I recall.

Q. The keys were in the ignition at that time, weren't they?

A. I think they were. I'm not too sure. I either asked him for them or they were in the ignition and I then looked in the glove compartment, in the trunk of the car, and I think we removed the back seat and looked under there.

Q. Mr. Ramirez was there at the time, wasn't he?

A. He was at the scene, yes.

Q. Yes. You never saw Mr. Lozoya get back into his car, did you, from the time, as you claim, that something was [233] transferred from his car to the Ramirez car?

A. He never got back into his car.

Q. That's right.

A. Once he was arrested?

Q. Yes.

A. No, he never got back into his car.

Q. You found the keys in the lock, didn't you?

A. I didn't say that. He either gave them to me——

Q. Didn't you find the keys or take the keys from the ignition?

A. I don't recall. I don't recall taking them from the ignition. I know——

Q. Wait a minute. Just answer yes or no, if you took the keys from the ignition.

A. If I might explain to you——

(Testimony of Meyer I. Goodman.)

That doesn't require any explanation.

The Court: He wants you to answer yes or no. Did you take the keys from the ignition or didn't you?

The Witness: Your Honor, I don't recall whether I asked for them from Lozoya or whether they were in the car. I believe I asked him for the keys to the ignition, and he gave them to me. That is my best recollection.

Q. (By Mr. Marcus): Didn't you testify not more than five minutes ago that you took the keys from the ignition and opened up the glove compartment? [234]

A. I didn't say that.

Q. You did not say that?

A. No, sir; I did not.

Q. You knew, didn't you, that he had never gone back to the car, that he couldn't have put the keys back into the ignition—you know that?

A. No, I don't follow you.

Q. If he had opened the trunk of the car and never got back into the car, he would have to have had those keys in his hands to open the trunk, wouldn't he?

A. I'm not too sure he needed the keys to open the trunk of his car. As I recall it, it is quite possible, I think that the trunk opened without the key—his trunk opened without the key.

Q. Let's not guess about it.

A. I'm not guessing. I'm telling you my best recollection, sir.

(Testimony of Meyer I. Goodman.)

Q. Isn't it a fact that you had to use the keys to open the trunk?

A. I don't think so. I'm not sure whether I did or not. I know that we opened it.

Q. You say you had the keys, you say you asked him for the keys or you got it out of the ignition, you don't know which.

A. The reason we took the key——

Q. Not the reason.

A. ——To try to start the car. [235]

Q. I want the facts, not the reasons. You opened the back of the trunk, didn't you?

A. The trunk was opened, yes.

Q. It was opened? A. Yes.

Q. Did you use the key to open it?

A. I don't recall whether we needed it or not.

Q. Did you have the keys in your hand?

A. I had the keys with me.

Q. Isn't it a fact, sir, that you went to open the back of the car to search the car in the presence of Ramirez and you couldn't open the door and you said to Mr. Lozoya, "Give me the keys," so he told you that if you wanted the keys to take them out of the car, you went to the front of the car, got in the seat and took the keys out; do you remember that?

A. That is untrue.

Q. That is untrue? A. Yes.

Q. Did you ask him for the keys?

A. I believe I asked him for the keys, and he gave them to me.

Q. That is your best memory?

(Testimony of Meyer I. Goodman.)

A. That is my best recollection, yes.

Mr. Marcus: Before we pass too far, Mr. Reporter, and with the court's permission, I would like to have you place [236] a marker, because I want to turn back, where he suggested about getting the keys out of the ignition.

The Court: All right.

Q. (By Mr. Marcus): Where was the ignition on this car? A. Right on the dashboard.

Q. You saw the ignition at that time?

A. Yes.

Q. How many of the officers helped you search the car?

A. I think there were one or two others.

Q. Mr. Ramirez helped you in the search?

A. No, sir.

Q. You opened the back of the car, didn't you? Whatever way you got into it, you opened it?

A. Yes, we took out the back seat, as I recall, and looked under it.

Q. Did you open the trunk, too?

A. The trunk was opened, yes.

Q. And you searched back there? A. Yes.

Q. You took out the seats of the car and searched there, too, didn't you?

A. Just the back seat, I believe.

Q. Did you search the front seat? Did you search the front seat area?

A. I think one of the officers searched in the front. [237]

Q. You testified that you opened the glove com-

(Testimony of Meyer I. Goodman.)

partment, didn't you? A. I did, yes.

Q. So that must have been in the front seat?

A. At sometime or other, yes.

Q. Did you search the floor boards?

A. Looked around the floor.

Q. Did you lift up the rug? A. No.

Q. At least, you made a search, as you are accustomed and have been instructed to make when you are searching for narcotics, didn't you?

A. We searched the car.

Q. Was that done in the presence of Ramirez?

A. He was on the scene.

Q. Well, he was right there, wasn't he?

A. Well he was not in the car with us.

Q. I didn't say he was in the car with you.

A. He was on the scene. He was standing somewhere. I was not looking at Ramirez.

Q. Didn't you then say, "Well, we don't find anything in this car"?

A. No. Do you know what I said? I said to one of the other officers, as I recall, "There is no more stuff in the car." That's all I actually said. [238]

Q. Well, you couldn't find anything in there, could you?

A. I said there was no more stuff in the car.

Q. Did you find anything in the car?

A. Nothing else in the car.

Q. Did you find any leaves or seeds or twigs or anything? A. Didn't see any.

Q. You won't answer the question directly, will you? A. No——

(Testimony of Meyer I. Goodman.)

Mr. Bender: The Government objects to the question on the ground that it is argumentative, your Honor.

The Court: Yes, I will sustain the objection.

Q. (By Mr. Marcus): Did you find anything resembling marijuana in the car?

A. I didn't see any.

Q. Can you answer that yes or no?

A. If you phrase it, did I or did I not find anything—will you rephrase it again?

Mr. Bender: The Government objects to the question on the ground that it is ambiguous.

The Court: He wants to know if you found any marijuana in the car.

Mr. Bender: Which car?

The Witness: I did not, sir. [239]

The Court: He said he didn't find any.

Mr. Bender: Counsel, which car are you referring to?

Mr. Marcus: If you had been listening you would know it was the car he was searching. He certainly didn't search the Government car.

Mr. Bender: I just wanted to make certain it is clear.

Q. (By Mr. Marcus): Did Mr. Lozoya ever tell you or admit to you in any conversation that he had any knowledge concerning any substance that you found in the Government car? A. No, sir.

Q. Did you go down to the station, too? Did you come here to the Federal Building?

A. Yes, sir; I did.

(Testimony of Meyer I. Goodman.)

Q. And was Mr. Lozoya brought in here?

A. Yes.

Q. Do you remember any other conversation that was held out there besides what you have related?

A. I don't remember any other, because I was not there.

Q. Did you say to Mr. Ramirez, "How does that stuff happen to be in this car"? Did you say that to him?

A. To Ramirez?

Q. Mr. Ramirez, yes, sir.

A. No, sir; I don't recall.

Q. Didn't he say, "This car is registered to my girl friend"? [240]

A. I don't recall that at all.

Q. Well, didn't you ask him how the stuff got into that car?

A. Did I ask who?

Q. Mr. Ramirez.

A. Are you talking about the sack?

Q. I am talking about the sack, yes, sir.

A. I saw how it got into the car.

Q. I didn't ask you what you saw. I asked you if you asked Mr. Ramirez how it got into his car?

A. I don't recall asking him.

Q. And didn't Mr. Ramirez say that the car didn't belong to him?

A. Lozoya's car didn't belong to him.

Q. No, I am talking about the Government car.

A. No.

Q. Didn't you ask Mr. Ramirez who owned the car?

A. I don't recall asking him that.

(Testimony of Meyer I. Goodman.)

Q. Wasn't there a conversation between you and Mr. Ramirez with respect to that '52 or '53 Mercury that Mr. Ramirez was in? Wasn't there a conversation with respect to that car?

A. I don't understand you, sir.

Q. Beg your pardon?

A. I don't understand you.

Q. I don't know how I can explain it any more. Didn't you [241] talk to Mr. Ramirez and ask him whose car the '52 or '53 Mercury was? I am referring now to the Government car.

A. The Government car?

Q. Yes, sir.

A. If you let me think back a moment, maybe I can——

Q. Let me refresh your memory a little bit, without your thinking. Didn't you ask Mr. Ramirez who the car belonged to?

A. I might have. I don't remember the particulars, sir.

Q. Didn't Mr. Ramirez say that the car belonged to his girl friend?

A. He might have said that.

Q. Well, does my suggestion to you about the conversation refresh your memory at all?

A. It doesn't particularly, sir.

Q. Didn't Mr. Ramirez tell you at that time, "You will have to ask my girl friend. I don't recall anything about the stuff that was in the car"?

A. He might have said that generally to all the officers present.

(Testimony of Meyer I. Goodman.)

Q. I don't care if he said it to all the officers present, or if he said it to you in particular.

A. I don't recall. I say, I don't recall.

Q. At least, at that time Mr. Ramirez was not known [242] as a Government agent to Lozoya, was he?

A. That is correct.

Q. And Villas was not known as a special employee of the Government to this man you called Johnny?

A. That is correct.

Q. Is that correct, too? You had seen Mr. Ramirez before and discussed the case with him, had you not?

A. That is correct.

Q. You had been at the conference involving Mr. Ramirez and Mr. Johnny Villas, hadn't you?

A. I spoke to Ramirez, that's all.

Q. You saw Villas there, too, didn't you, or Johnny, as you call him?

A. I saw him.

Q. You saw him before that evening, did you not?

A. I never spoke to him before.

Q. I didn't ask you whether you ever spoke to him before. I asked you if you saw him?

A. I don't believe I had ever seen him before.

Q. Didn't you see him in the Federal Building here?

A. I might have. I don't recall. I might have seen him.

Q. At least, it was your purpose at the time, was it not, to keep the identity of Mr. Ramirez unknown?

A. That is correct. [243]

Q. So there was a conversation there, wasn't there, about Ramirez and about the substance that

(Testimony of Meyer I. Goodman.)

was in his car, so that Mr. Lozoya would be off guard, would not suspect it?

A. That might be so, sir.

Q. You talked to Ramirez there that evening, didn't you? A. We had a brief conversation.

Q. What was said?

A. I don't recall exactly. I spoke—Ramirez was standing here, and Villas—I mean Lozoya was standing beside him, and at that time he had already been placed under arrest, and I asked——

Q. I understand that, sir. I am only interested in the conversation you recollect having with Mr. Ramirez that evening after you had come across the street. Do you remember anything that was said?

A. I don't recall specifically, but I might have said to him, "How did that stuff——"

Q. I don't want you to guess. If you don't remember, say you don't remember.

A. I don't remember. I just don't remember the words I said to him.

Q. But you do remember talking to him?

A. Yes.

Q. Does my suggestion to you with respect to what was [244] said that evening refresh your memory at all? A. Not particularly, sir.

The Court: Shall we stop at this time? Judge Carter is in my chambers. Is this a convenient time, Mr. Marcus?

Mr. Marcus: Yes.

(Testimony of Meyer I. Goodman.)

(Recess.)

Q. (By Mr. Marcus): Mr. Goodman, at this time I am anxious to ascertain what you actually saw while you were across the street. I understood you to say, sir, that you saw something taken out of one car and put into the other car; is that right?

A. Yes, sir.

Q. That is nothing that someone told you, was it?

A. That's right.

Q. It was something you actually saw with your own eyes?

A. Yes, sir.

Q. Did you see the Lozoya car approach the market?

A. No, I did not. I saw the ones in arriving there.

Q. Well, you were on the parking lot of the gasoline station; is that right?

A. That is correct.

Q. What corner of the gasoline station, on——

A. Well, I believe it is—it is directly across the street from the market. I couldn't tell you whether it is—I would say it is on the northeast corner. That is my [245] description of it.

Q. Does it face Beverly Boulevard?

A. Well, it is right on the corner. Part of it is on Beverly Boulevard, part of it is on Poplar.

Q. Poplar? A. Yes.

Q. Where is the market located?

A. Directly across the street from the——

Q. What corner?

(Testimony of Meyer I. Goodman.)

A. Well, I would say that it was on the south-east corner.

Q. Southeast corner of Beverly Boulevard and Poplar?

A. On the same side of Poplar as the gas station.

Q. Where is the entrance to the market? Is it on Beverly Boulevard?

A. There is an entrance on Poplar.

Q. There is an entrance on Poplar? Is there an entrance on Beverly?

A. There is an entrance on Beverly, too.

Q. The main entrance is on Beverly, isn't it?

A. I don't know if you would call it the main entrance. There are two entrances.

Q. Were you ever at that market?

A. I was never inside the market.

Q. Did you see the front door? [246]

A. Yes.

Q. Where was it that you saw it?

A. The front door of the market?

Q. Yes, that's right.

A. The front door of the market was on Beverly.

Q. Where did you see the car parked?

A. In the parking lot just behind the market.

Q. This park is on the rear of the market, wasn't it?

A. That is right, the parking lot goes all the way around the back and the side.

Q. Yes, but this parking lot that you say you saw Mr. Lozoya's car parked in was in the rear of the market?

A. That is correct.

(Testimony of Meyer I. Goodman.)

Q. And you are telling this court that you saw what was going on in the rear of the market?

A. The market is to one side.

Q. I understand where it is. It is right on the corner, isn't it?

A. Yes, but the parking lot——

Q. And you were on the northeast corner. Now, I am going to show you something (going to the blackboard). Look at this, will you? Is this the service station you are talking about? A. Yes.

Q. Is this the market you are talking [247] about? A. That is the one.

Q. Is this where the cars were parked?

A. No.

Q. Where were they parked?

A. May I show you?

Q. Just mark it on this. You said it was to the rear of the market, didn't you? A. Yes.

Q. There is a piece of chalk.

Mr. Bender: Which direction is north on the map?

Mr. Marcus: It is marked here north, south, east and west.

The Witness: Well, there is an entrance here.

Q. (By Mr. Marcus): Let's not change any of this map, though. You show me where the cars were parked.

A. The parking lot extends all the way around on both sides here.

Q. This is the market? A. Yes.

Q. Where was the car parked?

A. Both cars were parked here.

(Testimony of Meyer I. Goodman.)

Q. Both cars were parked here up against the back of the building?

A. Against the back of the parking lot.

Q. Were they parked against the building? [248] A. No.

Q. They didn't drive up against the building?

A. Against the market building?

Q. Yes.

A. No, sir; they were parked over here.

Q. Away from it? A. Yes.

Q. And you were over here?

A. No; over here.

Q. Here is the parking lot?

A. Yes, but here is the gas station, with parking area around it. We were over here.

Q. No, here is the gas station here.

A. Well, if this is——

Q. Let's not make it any bigger, please. What was the frontage of the parking lot of the service station?

A. I don't know. It was pretty——

Q. Give me an idea. A. It is a big——

Q. The service station itself, how large is it?

A. Oh, the actual building you mean? The building itself?

Q. Yes.

A. Or the building and the parking lot?

Q. The building itself, how large is it? [249]

A. The building itself is probably, I would guess, maybe 30 feet.

Q. You guess 30 feet? A. 40 feet could be.

(Testimony of Meyer I. Goodman.)

Q. 30 or 40 feet? A. Yes.

Q. This is a super market across the street, isn't it? A. That is right.

Q. How wide is that?

A. That is about maybe 50, 60 feet.

Q. It is a hundred feet, isn't it, the front of that market on Beverly?

A. I don't think it is a hundred. It might be 60 or 70. I am just guessing now.

Q. What is your best guess?

A. 60 or 70 feet.

Q. All right, 70 feet. What is the parking lot that adjoins the service station? How large is it?

A. It is very large—tremendous.

Q. How large is it?

A. Maybe—oh, maybe 120, 130 feet, something like that.

Q. Are you guessing again?

A. Well, I am just guessing—giving you my best judgment. [250]

Q. At least, you were some place in this area of the parking lot, weren't you?

A. I was 'way over on the side, near the back fence.

Q. This service station would be 30 or 40 feet, as compared to the market, which you say is 70 feet—that's half? A. Yes.

Q. And you were somewhere in this area, weren't you?

A. This is not a true picture of the parking area.

(Testimony of Meyer I. Goodman.)

Q. At least, from what you told us, you couldn't predict a true picture either, could you?

A. Yes, I could.

Q. Somewhere between 30 and 40 feet, and this might be 50 or 60 feet or something?

A. The parking area at the gas station extends maybe a hundred and thirty to a hundred and forty feet.

Q. We are talking about the market.

A. Yes, and the parking area of the market extends away over on this side.

Q. How far back did the parking area extend?

A. Oh, maybe 40 or 50 feet.

Q. How deep was the market?

A. I don't know. I couldn't tell you.

Q. The boulevard itself is approximately 100 feet, isn't it? A. The boulevard? [251]

Q. Yes.

A. I don't know how wide it is.

Q. At least, you were somewhere in here. You would have to look across there, and if you were in the station or immediately adjoining the station the market obstructed your view to the car, didn't it?

A. It certainly did not.

Q. Didn't obstruct it? A. Not one bit.

Q. And you could tell that the man was eating fruit over there, away back here where you claim it was parked? A. He was eating something.

Q. Was it to the rear of the parking lot where the car was parked?

(Testimony of Meyer I. Goodman.)

A. It was against the back portion of the parking lot.

Q. Not against the back portion of the building?

A. Of the market building?

Q. Yes.

A. No, it was way away from the market.

Q. Didn't you testify this morning that he parked parallel to Mr. Ramirez' car?

A. He backed in beside his car.

Q. Didn't you testify his car was ultimately parked parallel? A. Ultimately it was. [252]

Q. And didn't you testify that he was to the rear of the market building? Didn't you testify to that?

A. It was in the back lot of the market, in the back parking lot of the market.

Q. Didn't you testify it was to the rear of the building? A. I might have said to the rear.

Q. When the drawing is made and if you were over on this side, you knew you couldn't see through this building, didn't you?

A. I didn't have to see through the building.

Q. I know you didn't have to and you didn't look through the building, did you?

A. The cars were very, very apparent, both of them, in plain view.

Q. Did you talk this case over with Mr. Ramirez before you testified? A. When was that?

Q. At any time?

A. I think yesterday, he called me to come down to the office and that the case was going to be tried

(Testimony of Meyer I. Goodman.)

and asked me to come in. I was on leave at the time.

Q. I asked you if you talked over this case with Mr. Ramirez before you testified. Just answer yes or no.

A. Yes, parts of it, very scanty. [253]

Q. Did you talk to him about what you were going to testify to from the witness stand?

A. No.

Q. Did you talk to him about what the facts were as between you and Mr. Ramirez?

A. I didn't discuss that with him.

Q. Well, you said you discussed it scantily. You mean you discussed——

A. He told me that the Lozoya case was going to be tried and would I come down town.

Q. Did you talk the facts over with him with reference to the Lozoya case?

A. I didn't discuss it with him.

Q. Nothing?

A. Nothing that he didn't have. I would have, but I don't think the occasion arose for me to discuss it.

Q. Did you discuss with Mr. Ramirez as to the position of the two cars with reference to the market?

A. No; I didn't.

Q. Did you make any pictures there at the time?

A. At the time of the incident?

Q. Yes, or shortly after that as to where the cars were parked?

A. No; I made no pictures.

Q. Did you make any notes at the time? [254]

(Testimony of Meyer I. Goodman.)

A. I didn't make any notes, no.

Q. Everything that you testified to is with reference to your memory as to what transpired?

A. It is very distinct in my memory.

Q. I don't care whether it is—— A. Yes.

Q. ——distinct or not. That is for the court to determine. I am asking you if it is distinct in your mind. A. It is distinct in my mind.

Q. Did you testify that your best memory was that you took the keys out of the ignition?

A. No.

Q. Did you testify to that? Don't give me any explanation, please. A. No; I did not.

Q. Or your best memory was that you took the keys from the ignition; do you remember testifying to that?

A. I remember putting the keys in the ignition.

Q. Didn't you testify that you took the keys out of the ignition?

A. Eventually when I got out of the car, yes.

Q. Then did you take the keys out of the ignition?

A. After I had put them there myself, yes.

Q. You first put them in there yourself?

A. I tried to start the car, you see, [255] afterward.

Q. When you went to search the car, do you remember me asking you this afternoon if you did not go and take the keys out of the ignition? This is only within the past hour. A. Yes.

Q. I want to find out how good your memory

(Testimony of Meyer I. Goodman.)

is with respect to your testimony under oath now.

A. As I recall, my testimony was——

Q. No; did you so testify? Let's not guess about it. I have it marked in the record now.

A. I don't understand.

Q. Didn't you testify that, to your best memory or words to that effect, that you took the keys out of the ignition? Yes or no?

A. No; I don't recall saying that.

Mr. Marcus: Mr. Reporter, will you find that place in the record?

(Whereupon, the reporter read the record as follows:)

"Q. What examination did you make of this car?

"A. I asked him for his keys.

"Q. Yes, sir.

"A. And I think the keys were still in the ignition, as I recall."

Q. (By Mr. Marcus): Now, do you remember testifying to that? [256] A. I said——

Q. Do you remember testifying to that? Please don't make any explanations. Do you remember testifying to that under oath?

A. If that is what the record shows, apparently that would be it.

Q. Is that the truth? Yes or no?

A. I believe I said at the time——

Q. Not what you believe what you said. It is in the record now. Is that statement the truth?

A. That is not the whole statement.

(Testimony of Meyer I. Goodman.)

Q. Is that statement the truth, that you believe that you took the keys out of the ignition?

A. Yes; that statement standing by itself.

Q. That is all I want to know. A. Sure.

Q. That's all I want to know.

A. Everything I have told you is the truth, sir.

Mr. Marcus: That's all. Thank you, very much.

The Court: Do you have any more?

Mr. Bender: Yes, your Honor.

Redirect Examination

By Mr. Bender:

Q. Mr. Goodman, after you made that statement an hour or so ago, that testimony, did you then attempt to make any [257] qualification or explanation of your testimony?

Mr. Marcus: That is immaterial, your Honor.

The Witness: Yes, sir; I did.

Mr. Marcus: And that is no way to rehabilitate a witness.

The Court: I will let him say what he is going to say.

Mr. Marcus: The court is the best judge as to whether or not he made any qualification of that.

The Court: I am going to let him testify.

Q. (By Mr. Bender): Mr. Goodman, would you tell us again and relate to us your understanding of the manner in which you secured the keys to the automobile of the defendant Lozoya on May 17th?

Mr. Marcus: That is calling for a conclusion of

(Testimony of Meyer I. Goodman.)

the witness obviously, as to his understanding. We don't want the understanding. We want the facts.

The Court: I will sustain the objection.

Mr. Bender: I will withdraw it.

Q. Mr. Goodman, would you testify concerning the manner in which you acquired the key or keys to the automobile of the defendant Lozoya?

Mr. Marcus: That obviously calls for a conclusion of the witness. If he asks him how did he get the keys, that's all he has to ask him.

Mr. Bender: All right. [258]

The Court: All right.

Q. (By Mr. Bender): Mr. Goodman, how did you obtain the keys to the automobile of the defendant Lozoya on May 17, 1956?

A. As I recall. I asked Lozoya for them.

Q. What occurred then?

A. And he gave them to me, and I opened the glove compartment with them. I tried the ignition to see if the car would start, and it wouldn't start at the time. I couldn't get it to start, and that is about all we did with the keys.

Q. With reference to this blackboard, I am a little confused, because it seems to have north on the top and a north on the right, and east and west. I wonder if we could turn it around and start all over again.

The Court: Why don't we just use the same map?

Mr. Bender: Because I think it is——

The Witness: I think——

(Testimony of Meyer I. Goodman.)

Mr. Bender: Your Honor, the perspective is not drawn according to the situation.

The Court: Let him explain it, if he wants to.

The Witness: Well, this is Poplar Street, your Honor.

Q. (By Mr. Bender): By "this," which street do you mean? A. This street here.

Q. Which direction does that run? [259]

A. It runs north and south, I believe, and Beverly runs east and west, and the market is on this corner in that relationship, and the gas station is on this corner, your Honor.

Q. Poplar Street runs north and south? Is the position of the east and west correct? It appears to me that it is reversed.

A. I believe it is. I think this is actually the southerly direction, your Honor. This is the notherly direction.

Mr. Marcus: North is to the——

The Witness: Well, not necessarily up.

The Court: In drawing the map, you always put north to the top.

Mr. Bender: Yes, but you put east to the right. They have it backwards.

The Witness: That is right.

The Court: Let him explain it.

Mr. Bender: That is why it doesn't appear that the position of the market——

Mr. Marcus: If it is confused, why not just change the east and west?

(Testimony of Meyer I. Goodman.)

The Witness: I think the north and south should be changed.

Mr. Marcus: It couldn't be. [260]

The Court: Just change the east and west.

Mr. Bender: Your Honor, if you change the north and south, you don't have the correct perspective, because that would then place the service station on the northeast corner.

The Court: How many more questions do you have of this witness?

Mr. Bender: Quite a few, your Honor. I want to go fully into the exact location of——

The Court: Well, draw the map and start that the first thing in the morning. Draw the map the way he wants to draw the map on the other side of the board.

We will adjourn until 10:00 o'clock. Have him draw the map, have him draw it in the meantime, and we will start with that—the way he wants the map drawn. There is a blackboard on the other side, isn't there?

Mr. Bender: Yes, and as I understand that can be erased?

The Court: All right, erase that, and have him draw it after court.

Mr. Bender: The Government at this time again moves to introduce in evidence Government's Exhibits 1-A, 1-B and 1.

Mr. Marcus: Obviously, at this time, I would suggest, because of the character of the testimony

(Testimony of Meyer I. Goodman.)

that has been put on so far, that your Honor reserve——

The Court: I will reserve the ruling.

Mr. Bender: May the Government be heard on that before [261] the court——

The Court: All I am doing is reserving the ruling.

Mr. Bender: Yes, but your Honor, in the event the court is, as has been indicated, unwilling to accept this evidence today, it places us in the position of having to make a decision whether or not to bring the chemist down from San Francisco.

The Court: You don't need the chemist. He has already stipulated in the written stipulation. I understood that was your position.

Mr. Marcus: Yes, your Honor.

The Court: He has already stipulated that the chemist, if called, would testify that, in his opinion, the substance he examined was marijuana, and that is as far as he could go. He is not disputing that.

Mr. Bender: He has stipulated to far more than that. That's the point. If we find tomorrow that we are ready to close and we are not in the position of having the chemist here, and then counsel argues that the scope of the stipulation does not include what we anticipate the chemist would testify to, if we call him tomorrow morning, we would be in the position of not having the witness available to proceed.

The Court: Well, what Mr. Marcus has, and what the court has ruled so far, and reserved rul-

(Testimony of Meyer I. Goodman.)

ing, is that you haven't made the link between that Exhibit 1 and the defendant. [262]

Isn't that your position now?

Mr. Marcus: Yes, your Honor.

The Court: Up to this time I have reserved ruling on it. I never passed final judgment. But he made that point, and that is what I said this morning. He is not contending about——

Mr. Bender: Well, your Honor, it is the Government's position that we have clearly established that link, and I would like to argue that and have it determined today, so that if the court is of the opinion that we have not established that, we may obtain the expert witness.

Mr. Marcus: I am willing to do this with counsel, even though he hasn't tied it up and he has to have the Government witness, and if he has to have the Government witness, under his theory, he can bring him at any time.

Counsel, my position is this. You have not tied up these items here with this defendant. This witness himself has testified that he doesn't know that this is the same stuff that was taken out of the car. The other witnesses testified that he doesn't know that that stuff came from this defendant. That is the link.

Mr. Bender: The Government's answer to that is that it is totally immaterial whether they know that or not. I don't think any Agent has, in any narcotic case, to testify that it was the same stuff. It is impossible of identification [263] of a handful

(Testimony of Meyer I. Goodman.)

of marijuana out of a sack as being the same marijuana that was placed in the sack.

Mr. Marcus: I am not concerned about what happens in other cases.

The Court: They are just putting you to your proof. Mr. Marcus is advancing that thought. That is what I thought this morning.

Mr. Marcus: That is correct.

The Court: That is the argument he is making.

Mr. Bender: The Government's position is that that has been satisfied. I would like to go fully into the Government's position concerning the background.

The Court: I think the thing for you to do, if you feel that way, is to have the reporter read you the testimony of the Narcotics Agent, who said—Mr. Marcus took him on cross-examination and he used the words, he said “absolutely,” that he did not know that this was the substance that this defendant was supposed to have.

Mr. Bender: Of course, your Honor, and the Government never intended to prove its case by testimony by an Agent to the effect that that agent could identify the same material as being——

The Court: How do you connect Exhibit 1 with the defendant?

Mr. Bender: Very easily, your Honor. Start back with Ramirez having been present when the 10 pounds or so of this [264] stuff was transferred by the defendant into the car of the Agent. Then you have Agent Ramirez weighing it and sealing

(Testimony of Meyer I. Goodman.)

it and mailing it with these bags, Government's Exhibit 1, the bags containing material that resembled marijuana, to the chemist in San Francisco. Surely there is a presumption as to the regularity of the mails. It is sent by registered mail. We then have it received by the chemist in San Francisco. The stipulation says that the chemist, R. F. Love, received Government's Exhibit 1 by registered mail from Joe Ramirez.

The Court: I understood the Agent testified that he couldn't identify this as being the substance taken from the defendant.

Mr. Bender: He identified the burlap bag and all of the paper sacks with his initials contained on them, and states there was substance in it which resembled marijuana. It would be impossible for anyone to identify the exact substance as being what he has mailed, because marijuana is marijuana.

The Court: What is your thought on that, Mr. Marcus?

Mr. Marcus: It is obvious, your Honor, that there has been no testimony at this time in this record to identify this marijuana offered in this courtroom as being the marijuana that was taken from the defendant.

The Court: You were trying to get Mr. Marcus to stipulate [265] to that, and he wouldn't do that. He said he was putting the Government to proof.

Mr. Bender: At this time it is the Government's position that it has been proved, if you consider the

(Testimony of Meyer I. Goodman.)

testimony that has been elicited as well as the stipulation. The stipulation states that Exhibit 1 was received by the chemist from Ramirez. It further says that Exhibit 1 will be identified by Agent Ramirez. He identified it. He identified the paper sack and the bag. The bag is the one he received from the defendant Lozoya. The paper sacks are the ones he received from Lozoya, initialed and forwarded to San Francisco.

The Court: Well, I will have the reporter—we will stand in adjournment, and the reporter will read the cross-examination and the voir dire examination, when you brought that out from the Agent, because somebody used the word “absolutely.”

Mr. Marcus: I used it, your Honor.

The Court: You used the word, and I think he said “yes,” and I would like to have that testimony, and we will find that place and go on from there.

Mr. Bender: But, your Honor, the Government's position is to concede that the Agent testified that he was not able positively to identify the leafy substance contained in these paper sacks as being the identical substance that he mailed to the chemist in San Francisco. The Government's position [266] is, and we submit it is necessarily so——

Mr. Marcus: Not mailed to the chemist in San Francisco, but what he got from this defendant. That's the point.

Mr. Bender: He testified to that.

Mr. Marcus: He can't identify this substance as

(Testimony of Meyer I. Goodman.)

being the substance that he took from the defendant. It's just that plain.

The Court: We will stand in adjournment and I will have Mr. Swader read it, so you won't have to have the written testimony. You can have him read you that point. Then, in the morning, you can both call my attention to the particular portions. I will rule on the matter at that time.

Mr. Bender: The Government will not be prejudiced, then, will it, by failure to obtain the chemist?

The Court: The chemist has nothing to do with it, really. That doesn't prejudice your case at all. The key to the thing is your Narcotic Agent. You write down what you think is material, and Mr. Marcus will have the page number, and then the question in the morning, tomorrow morning, we can have the reporter read it, if there is any question about it. He should be able to find it fairly quickly. Mr. Marcus asked the key question somewhere along the line. Then I used the expression that you had a "missing link." If you get the court's remark about the "link," that's what we are concerned with. [267]

Mr. Bender: That is the Government's position. There is no such thing as a missing link.

The Court: You advanced that argument this morning.

Mr. Bender: That is correct.

The Court: You have been consistent. You have maintained that the link was in the chain.

Mr. Bender: Yes, your Honor, that is the Government's position, that it is contained within the

(Testimony of Meyer I. Goodman.)

stipulation. If it is the court's position that the stipulation doesn't include it and that the chemist has anything to do with the missing link, as the court has termed it, then the chemist should be here to clear it up. If it is the court's position that the missing link consists of the failure of Agent Ramirez to identify this identical leafy substance as being one he obtained from the defendant, I don't see how any agent could ever clearly identify it.

Mr. Marcus: That is a matter of argument, and that is a matter of putting the Government to proof. As to how they are going to do it is not up to us.

Mr. Bender: Of course, I am arguing that it should be admitted in evidence. This is the time to argue it.

The Court: I understand it. We all three could be mistaken on it. So we will have the reporter read the testimony to both of you and then we can hear you. I could be wrong. But I remember you asked the question and you used the word [268] "absolutely" and the witness said he could not identify it, and I think I used the expression at that time that there was the missing link, in my opinion. I know you disagree with me. [269]

Mr. Bender: May I make one further point, your Honor?

The Court: Yes.

Mr. Bender: That is, that this witness presently on the stand has been qualified as an expert to testify, and he gave his expert opinion concerning whether this substance is marijuana.

(Testimony of Meyer I. Goodman.)

The Court: He has, and that goes to weight and credibility. He has given his opinion that it is marijuana.

Mr. Bender: He has testified that, in his opinion, Government's Exhibit 1, including the substance contained in the paper bags, is presently marijuana and at the time it was obtained on May 17th from the defendant it was marijuana, and on his testimony alone these exhibits should be admissible.

Mr. Marcus: He hasn't testified that this substance that he looked at now——

The Court: All the court is going to do is reserve ruling on the record until the reporter reads you the testimony, and if you stay here the reporter will read it to you now. Then we will resume from there in the morning. We all could be mistaken. I could be mistaken.

Mr. Bender: The minute the Government determines that it is necessary to bring the chemist down, would the court preclude the Government doing that if it means taking an extra day?

The Court: Oh, no. I still say you don't need the [270] chemist. But if you want the chemist, it is all right with me.

Mr. Marcus, you're not advancing that argument?

Mr. Marcus: I am not. The chemist has nothing to do with this.

The Court: In the stipulation, he stipulates that the chemist would testify that it was marijuana, the substance that he examined. He is not contending that.

(Testimony of Meyer I. Goodman.)

Mr. Bender: And that the substance he received from Jose Ramirez—he stipulates that?

Mr. Marcus: That is right. But go one step further. Agent Ramirez says he doesn't know that this stuff is the same that he took from the defendant.

Mr. Bender: But he received it by registered mail, as he testified, from the chemist.

Mr. Marcus: You're talking about the chemist received it by registered mail.

The Court: Well, have him read the record. The reporter is here. We'll catch him right now, and we will start in from that at 10:00 o'clock in the morning. If I am mistaken, I'll admit my mistake. It is hard to remember all this testimony in these narcotic cases.

(Adjournment until Thursday, July 19, 1956,
at 10:00 a.m.) [271]

Thursday, July 19, 1956—9:30 A.M.

The Court: All right, Mr. Bender, did your witness draw the map on the board?

Mr. Bender: We had just commenced doing that this morning, your Honor.

Mr. Marcus: Does your man have the exact measurements, Mr. Bender?

Mr. Bender: That I don't know.

Mr. Marcus: I have a map drawn on this, and I have the exact measurements. If it will be of any assistance, you may use it.

Mr. Bender: I see you have the east on the right this time.

Mr. Marcus: You may put it right up there.

Mr. Bender: May I have a moment to look at the map, your Honor?

The Court: Certainly.

(A pause.)

(Mr. Bender returns the document to Mr. Marcus.)

Mr. Bender: Your Honor, we have decided to have him draw it on the blackboard, in view of the fact that there are some features about the proffered map that we don't care for.

The Court: All right. [274]

MEYER I. GOODMAN

called as a witness for the plaintiff, having been previously duly sworn, resumed the stand and testified further as follows:

Redirect Examination

(Continued)

By Mr. Bender:

(Witness draws on the blackboard.)

Mr. Marcus: Shouldn't that east and west be changed?

Mr. Bender: No; that is correct now; east is on the right.

The Witness: I wanted to draw it to coincide with the way you have it, Mr. Marcus.

(Testimony of Meyer I. Goodman.)

Mr. Bender: No; draw it the way that it is, Mr. Goodman.

The Witness: All right.

(Witness drawing on the blackboard.)

The Witness: This is Beverly, this is Poplar (marking the diagram).

Q. (By Mr. Bender): Mr. Goodman, the way I have observed your map drawn, the north is at the top, south, of course, is at the bottom; east is to the right; west is to the left; that is correct, is it not?

A. That is correct.

Q. And you have two areas dotted in?

A. Yes.

Q. What is the area that is dotted in? [275]

A. The area that is dotted in signifies the extent of the parking area behind the structures.

Q. Directing your attention to the area that is dotted in, in the northeast corner, the upper right-hand corner, what area does that represent?

A. That entire area represents the gas station and the parking area surrounding it.

Q. Would you draw an X indicating the approximate position of the government vehicle that you say you were near in the company of Agents Cantu and Miller on May 17, 1956?

A. We were right here—right there (indicating).

Q. Approximately how far is that spot indicated as being right here from the intersection or corner of the northeast boundary? By that I mean, start-

(Testimony of Meyer I. Goodman.)

ing from the north and going in a southerly direction until you reach Beverly Boulevard and being on the east side of Poplar—in other words, at the point I am indicating with my finger?

A. Yes.

Q. How far is it from this point, approximately, to where your car was parked?

A. Oh, it would have to be a very rough estimate, Mr. Bender. I didn't at any time measure it, but I would guess perhaps between 75 and a hundred feet perhaps, or maybe even a little more.

Mr. Marcus: Pardon me just a moment. What does that [276] 75 or 100 feet he has given us a rough estimate of?

The Witness: From this corner here to where our car was at the gas station——

Mr. Marcus: That is, he indicated on the map from the northeast corner of Poplar and Beverly Boulevard directly east to a point where his car was parked on the parking lot.

Mr. Bender: Yes; on Beverly Boulevard.

The Witness: That is right.

Q. (By Mr. Bender): What does the dotted area and the printed M signify or indicate at the southeast or lower right-hand portion of the map?

A. The dotted area indicates on the southeast portion the extent of the market and parking area—the entire land, so to speak, of the parking area.

Q. Would you draw the approximate size of the Beverly Ranch Market?

(Testimony of Meyer I. Goodman.)

A. Yes. It would be a little larger than this probably.

Mr. Marcus: Counsel, I have the exact measurements here. It was measured. If you want to accept it instead of guessing on this thing, it might be of some assistance to the court.

Mr. Bender: Well, he is giving his best recollection.

Mr. Marcus: I know, but we have the exact measurements.

Mr. Bender: Well, if you have them, you had a perfect opportunity to present them [277] yesterday.

Mr. Marcus: I didn't have the exact measurements yesterday. They were made last night.

The market is 124 feet frontage on Beverly Boulevard.

Mr. Bender: Well, counsel, you, of course, will have the opportunity to present that.

Mr. Marcus: Why guess about this witness' testimony, if he doesn't know?

Mr. Bender: He is giving his best estimate, just as any witness is permitted to give his best estimate.

The Court: I will permit him to give his best estimate. Go ahead.

The Witness: That is approximately the size of the market, in comparison to the size of the station, perhaps a little bigger or a little smaller.

Q. (By Mr. Bender): Is the market, then, larger in area than the station?

(Testimony of Meyer I. Goodman.)

A. The market itself?

Q. Is larger than the station structure?

A. Oh, yes; of course, quite a bit larger. The gas station structure itself is comparatively small in comparison.

Q. In an easterly direction off of Poplar Street, would the area that you have indicated be the point indicated where his car was parked, did that extend as far or less or farther east than the easterly edge of the market itself?

A. Did the parking area extend further east than—— [278]

Q. Yes; where your car was parked, was it further east off of Poplar than the most easterly edge of the Beverly Ranch Market?

A. Oh, yes; a good deal further east of the structure of the building of the market itself. The parking area where we were located and the car we were situated in.

Q. Now, would you place the position of the Government's vehicle which was occupied by Agent Ramirez, the position on the Beverly Ranch Market parking area?

A. Yes; by this little line, I would say, just about there (indicating), with its back wheels up against it looked like a tree stump, one of those tree stumps as a stop laying on the ground.

Mr. Bender: Counsel, will you stipulate that the witness has marked an area on the Beverly Ranch Market parking lot which is farther east off of

(Testimony of Meyer I. Goodman.)

Poplar than the most easterly extremity of the Beverly Ranch Market?

Mr. Marcus: Yes, sir; for the purpose of the record, although I am not stipulating to the proof.

Mr. Bender: Of course not.

Mr. Marcus: I am stipulating to the fact that he has marked it as such.

Q. (By Mr. Bender): Now, Mr. Goodman, would you mark the area where you testified the defendant and the 1940 or '41 Chevrolet automobile was first parked and stopped when it [279] entered the Beverly Ranch Market parking lot?

A. Yes. It first came to a stop right about here at this dot right there.

Q. And in which direction was it facing when it first came to a stop?

A. It was facing this way. It had come in from this direction and was facing this way.

Q. Facing east?

A. Facing east, yes. Then the car backed around into this position here.

Q. Meaning into a parallel position with the government car?

A. Parallel; that is correct.

Q. And at that time both cars were then facing in a northerly direction?

A. They were both facing me as I was looking south.

Q. Mr. Goodman, did you teach the identification of the cannabis plant at the time you were teaching chemistry? A. Just as one of the lessons.

(Testimony of Meyer I. Goodman.)

Q. Will you explain what the cannabis plant is?

A. The cannabis plant is a plant which is indigenous to most temperate areas of the world and is a plant which I have seen growing up to a height of seven or eight feet. It is a very distinctive plant in that there are several characteristics of it which are differentiated from all others, [280] and that is that the combination of things such as the saw-toothed margin of the elliptical leaf—the leaf is an elliptical shaped leaf, a long, narrow elliptical shaped leaf, and that has a saw-toothed type of margin all around the edge. That leaf grows on the end of a frond type or palm type stalk, coming from the branches—the main stalk of the plant. A very characteristic thing, and one which we use to identify the plant very often with, is the fact that each leaf, each hand of the leaf always grows in odd numbers. In other words, it is either three leaves on a palm, five leaves on a palm, seven leaves on a palm, nine, eleven or even up to thirteen leaves, single individual leaves on each palm.

Another very characteristic thing about the plant is that each pair of branches on the main stalk grows alternately, and by alternately the individual means that each pair of stalks grows alternate to the one below or above it. In other words, if the main stalk is the trunk of my body and there are two stems coming off the trunk, your Honor, these grow in this direction, the next two above it will grow at exactly right angles, then the next two above it will grow like that (indicating), and al-

(Testimony of Meyer I. Goodman.)

ways the leaves are in odd numbers. It's a very characteristic and significant thing.

Q. Did you teach this identification of the cannabis plant to the pupils?

A. Yes; I did. [281]

Q. What is the color of this cannabis plant at the time it is growing?

A. It is a bright green leaf.

Q. After it has been cut and permitted to dry, does it change color?

A. Yes; it changes in color all the way down to a pale brown to a buff color I have seen it.

Q. What characteristics does it retain that you can identify by physical inspection and examination?

A. It retains the characteristic and distinct odor, it retains the clustered mottled type of seeds that are attached to the leafy material, it retains the portions of the calcium carbonate, little calculi or stones in the glandular parts of the leaf. Those are among a number of things it retains.

Q. What is a common understanding or word to indicate or mean, or correlate with the cannabis plant? What is the cannabis plant?

A. The cannabis plant is commonly known as the hemp plant. It is the hemp.

Q. And what is the hemp plant known as?

A. It has many slang terms, of course.

Q. Is one of them marijuana?

A. Yes, marijuana. It is called—just called plain weed. That is a very common expression.

(Testimony of Meyer I. Goodman.)

Q. Or stuff? [282]

A. Stuff, grass. Out here on the West Coast I have noticed they use a number of terms that are not used in the east; they call it grass very often here. "Can I have a pound of grass?"

Q. Are you familiar with any of the expressions that are used to designate marijuana in Spanish?

A. Not too well. I don't speak——

Q. Do you speak Spanish?

A. No; I don't.

Q. As I recall, you testified that you made an examination or inspection of the automobile of the defendant at Beverly Ranch Market on May 17th; is that correct? A. That is correct.

Q. Did you make some comment to one of the other officers after you had looked in the automobile of the defendant? A. Yes; I did.

Q. What comment was that?

Mr. Marcus: That is objected to as being hearsay and self-serving, whatever it might happen to be, your Honor.

Mr. Bender: Your Honor, the Government will withdraw that question and ask a further—one or two further foundational questions.

The Court: All right.

Q. (By Mr. Bender): Mr. Goodman, was this comment made [283] in the presence of the defendant? A. Yes.

Q. Approximately how far from you was the defendant at the time you made this comment?

A. About five or six feet.

(Testimony of Meyer I. Goodman.)

Q. What did you say to the other officer?

A. I said——

Mr. Marcus: Just a minute, please. Your Honor, whatever he might have said to another officer in the presence of the defendant, unless it would call for a reply, in the first place, it would be immaterial; in the second place, he might have said a thousand things, but it wouldn't make any difference as far as this case is concerned—it would be immaterial.

The Court: I'll overrule the objection.

Mr. Bender: As a matter of fact, the question was asked by counsel and answered yesterday, and I objected to it.

The Court: He may answer it.

Mr. Bender: Thank you.

The Witness: As I came out of the car, after searching it, I recall saying to several of the other officers who were standing close to the defendant, "There is no more stuff in the car. We might as well go down town," or words to that effect, and he was standing right there.

Q. (By Mr. Bender): Now, Mr. Goodman, you testified [284] yesterday concerning the conversations that took place at the scene of the arrest at the Beverly Ranch Market parking area. Do you at this time recall any further conversations that occurred that you did not testify to yesterday?

Mr. Marcus: He was asked that question yesterday, if your Honor recollects, and he specifically inquired of this witness whether there was anything

(Testimony of Meyer I. Goodman.)

in addition to what he has stated was said there or done there at the time, and he said there wasn't.

Mr. Bender: That is not a basis for objection, your Honor.

Mr. Marcus: It is objected to because it has been asked and answered, your Honor.

The Court: I'll sustain it on the latter ground. It has been covered.

Q. (By Mr. Bender): At the scene of the arrest on May 17, 1956, did you have any conversation with Agent Ramirez? Did you say anything to him?

A. Well, at that time——

Mr. Marcus: Yes or no, please. That would call for a yes or no answer.

The Witness: Yes.

Q. (By Mr. Bender): What did you say?

Mr. Marcus: That is objected to as being immaterial and hearsay, your Honor. [285]

The Court: I will let him answer. I will overrule the objection. He may answer.

The Witness: I said to Ramirez, who, at that time, was taken as an alleged defendant along with Lozoya, "Whose car is this black Mercury?" And he replied something to the effect that it was his girl friend's car, as I recall now. That was about the extent of it. There was very little more said.

Q. (By Mr. Bender): And you now recall that you made that statement to him?

A. I remember saying words to that effect, and he replied it being his girl friend's car, that it was not his car, and the defendant was standing there.

(Testimony of Meyer I. Goodman.)

Q. Did you recall that yesterday at the time you testified? A. It was very——

Mr. Marcus: Just a minute, please. Your Honor, that is no way to rehabilitate a witness. This witness was never asked that direct question yesterday and he responded that he had no memory with respect to that conversation.

Mr. Bender: I'm not rehabilitating him. I'm only asking him when he recalled this.

Mr. Marcus: It wouldn't make any difference when he recalled it. He testified to it this morning. That is proper for cross-examination. [286]

The Court: I'll sustain the objection.

Mr. Bender: No further questions, your Honor.

Recross-Examination

By Mr. Marcus:

Q. Mr. Goodman, when both cars on the market parking lot came to a stop parallel to one another, was the front end of each of the cars facing you?

A. The front end of each of the cars? —

Q. Yes. A. Yes.

Q. And the rear end was further away from you?

A. That is right; the length of the car.

Q. Therefore, isn't it a fact, sir, that anybody walking or doing anything or performing any act at the rear of the automobile, from the position that you were standing——

A. Yes.

Q. ——would be to the rear of the cars that were

(Testimony of Meyer I. Goodman.)

parked on the parking lot? A. Yes.

Q. So if there was any movement to the rear of the automobile, the body of the car, the top of the car would be between you and the persons that were in movement at the time on that parking lot of the market? A. Partially.

Q. Well, the body would be between you, [287] wouldn't it? A. Partially.

Q. Well, sir, if you can tell me how a piece of a body and not the entire body would be between you where you were standing at this position, as you claim, marked X, and the people who were moving to the rear of the automobiles, I would like to have you explain that to the court.

A. That's very simple.

Q. All right; you come down to the board and—first, let me lay a preliminary preface here. Mark 1 and 2 for the rear of the automobiles that were parked. A. Where do you want 1 and 2?

Q. Just to the rear of the automobiles.

A. Which automobile do you want?

Q. Both of them—it doesn't make any difference, one or the other.

Mr. Bender: Indicate which one you are marking, Mr. Goodman.

The Witness: I mark No. 1, the defendant's car, and No. 2, Ramirez' car.

Q. (By Mr. Marcus): You were at position X?

A. That is correct.

Q. And was the movement between the two cars

(Testimony of Meyer I. Goodman.)

at the rear of the cars when you say something was transferred from one car to another?

Mr. Bender: The Government objects on the ground that [288] there is a question pending which has not been answered.

Mr. Marcus: I am laying a preliminary statement first.

Mr. Bender: You asked the witness to explain.

Mr. Marcus: Let me withdraw the question.

Mr. Bender: I suggest that he be permitted to explain.

Mr. Marcus: May I withdraw the question?

The Court: The question is withdrawn.

Q. (By Mr. Marcus): Now, sir, were the cars 1 and 2 parallel to each other?

A. That is correct.

Q. Were they both facing toward the north?

A. That is correct.

Q. Now, sir, you said that the parts of the body of the car were not between you as you were facing south and the people who were in movement in positions 1 and 2 and you said you could explain that to the court. Explain to the court how portions of the body of the automobiles were not between you.

A. Which do you want me to explain now?

Q. Go ahead and make the explanation.

A. I'll be happy to. It was a very simple matter for me to see right to the rear and see both these individuals. There was a space between the two cars.

Q. Just a moment, Mr. Goodman.

(Testimony of Meyer I. Goodman.)

Mr. Reporter, will you read the question?

The Witness: I heard the question. [289]

Mr. Marcus: Just listen to it again. I didn't ask you what you could see. That will be for the court to determine, what you could see.

Q. My question was, propounded on the basis of your answer that you said that portions——

A. You asked me how I could see.

Q. Just a moment, Mr. Goodman, please. I asked you whether or not any portions of the car, the body and the top, were not between you and the people who were in movement, and you said yes.

A. I said partially.

Q. Partially? A. Yes.

Q. Now I'm asking you to explain how portions of the car were between you and the people in movement and portions of the car were not between you and the people that were in movement?

A. Between me, or between my view. I didn't say what you said.

Q. I didn't ask you about any view at all.

A. Oh, between me and the car?

Q. Yes.

A. Well, the entire car would naturally be in front of me, and the rear of the car would be to the back of the front portion of both vehicles. [290]

Q. Both cars and the entire portion of both cars were between you and the people who were in movement to the rear?

A. Naturally; that's correct.

Q. How far apart were these cars?

(Testimony of Meyer I. Goodman.)

A. Oh, the usual parking space (indicating).

Q. Describe what is usual.

A. I don't know. I didn't measure it.

Q. Well, you looked down there and apparently you saw, as you claim you saw——

A. I would say maybe ten feet apart.

Q. They were that far apart?

A. Approximately; maybe eight, ten feet. I'm just estimating it.

Q. And this movement took place between the two cars and from the front of one car to the trunk of another?

A. Yes; that's correct.

Q. And you observed that when the trunks of both cars were up; is that right?

A. That is correct.

Q. Take the stand again.

Mr. Goodman, did you see somebody open the trunk of the car from where you were standing?

A. Which car?

Q. Either car.

A. I saw Lozoya go to the back of his car and open the [291] trunk.

Q. And you could see that from where you were?

A. I most definitely could.

Q. And the car—please wait until I finish the question.

A. I'm sorry.

Q. From where you were standing, you could see him open the rear of the trunk of the car?

A. I could.

Q. Yes or no?

A. Do you mean did I see him put a key in it or

(Testimony of Meyer I. Goodman.)

what? I saw him go to the rear of the car and the trunk was then opened.

Q. Did you see the trunk open?

A. I saw the trunk open, yes.

Q. That answers it. Just answer yes. Did you see the trunk of the other car opened?

A. Yes.

Q. And the entire front of the car was between you and Mr. Lozoya, wasn't it? A. Yes.

Q. And you could see from where you were standing him open the trunk of the car and the top of the trunk open up; is that correct?

A. That is right. [292]

Q. Then you saw him take something out of the trunk? A. That is correct.

Q. Now, Mr. Goodman, you know it is a human impossibility—— A. That is untrue.

Mr. Bender: Just a moment. The Government objects——

Mr. Marcus: You don't know what the question is yet, do you?

The Witness: Well, you said it is a human impossibility.

Mr. Bender: To that question the Government would like to interpose an objection, first, that it is argumentative, and, second, that it is asking for a conclusion of the witness, your Honor.

The Court: Yes. I'll sustain the objection on the grounds that it is argumentative.

Q. (By Mr. Marcus): Now, you say you taught the plant cannabis?

(Testimony of Meyer I. Goodman.)

A. It was just one of the brief subjects that was covered in——

Q. Would you answer me one question yes or no?

Mr. Bender: The Government objects to this statement by counsel as being beyond the bounds of permissible questioning for an attorney. His comment in that regard should be directed to the court, to request the court to instruct the witness to answer, and he has repeatedly throughout this [293] trial evidenced the approach of telling the witness what to do and what not to do.

Mr. Marcus: I didn't tell him what to do or what not to do. I asked him if he could give me a yes or no answer.

The Court: I'll overrule the objection.

Q. (By Mr. Marcus): Could you answer the question yes or no, Mr. Goodman?

A. I'll try.

Q. Did you teach the cannabis plant to a class?

A. Yes.

Q. What class was that?

A. It was a class—I think it was several classes I had in which that was discussed. There was one class at the university in which we had a class in materia medica, which is the study of the appearance, action, uses of various botanical drugs and other drugs; and then the other class——

Q. Just tell me what class it was. Could you tell me the name of the class, and what university?

A. Yes; class in materia medica at the Middlesex University.

(Testimony of Meyer I. Goodman.)

Q. Middlesex University? A. Yes.

Q. And you were the instructor there?

A. I was the instructor in that class, yes.

Q. Did you have an instructor's permit or license to [294] instruct at the time?

A. Well, I was employed by the university. There was no license required.

Q. You didn't have a teacher's license to teach in the university, did you?

A. The university did not require one.

Q. That was not my question. A. No.

Q. Did you have a——

A. I don't recall having one.

Q. ——a teacher's certificate to instruct at that university? A. In Massachusetts?

Q. I don't know where it is, sir.

A. Well, it's in Massachusetts.

Q. All right, it's in Massachusetts. Now tell me if you had a teacher's permit.

A. Universities do not require——

Q. I don't know what they require. I'm only asking you if you had a teacher's certificate?

A. No.

Q. You say that you instructed on the plant cannabis? A. That is correct.

Q. What is the entire name of the cannabis plant?

A. Cannabis sativa, cannabis indica—there [295] are various genera.

Q. You say it comes from the hemp plant?

A. That is the common name of the plant or one

(Testimony of Meyer I. Goodman.)

of the varieties is the common name for the hemp.

Q. Is there any name in addition to hemp plant that you know?

A. Well, it's called cannabis plant.

Q. Yes, sir; you've told us that.

A. There may be other synonyms for the name. I don't recall them offhand.

Q. Mr. Goodman, isn't the common name of cannabis sativa known as Indian hemp?

A. Cannabis indica; I said that.

Q. I didn't say "indica"; I said Indian.

A. Indica is Indian.

Q. You have told us that the plant itself, the leaves were in odd numbers; is that right? [296]

A. Yes; very characteristic.

Q. And you gave us some discussion concerning the various branches coming out perpendicularly to each other? A. That is correct.

Q. I assume, sir, that, basing your testimony upon that knowledge, when you looked at this sack, as you claim that you did at the time you determined that it was marijuana because the portion that you looked at showed the leaves to be horn-type and that the branches protruded perpendicularly to each other; is that right?

A. I did not use that as a—

Q. You didn't? A. I did not.

Q. You didn't use that knowledge, did you, to testify?

A. I did not use those, because they were not present in this material.

(Testimony of Meyer I. Goodman.)

Q. So it was not of any assistance to you, was it?

A. Assistance in what? In——

Q. In determining whether this plant was cannabis sativa?

A. That knowledge didn't play a part, no.

Q. I want you to look at this twig here. Is this cannabis sativa?

A. It is impossible to tell which variety it is right now.

Q. I didn't ask you which variety it is. [297]

A. I don't know.

Q. You can't tell whether this is cannabis sativa or commonly known as marijuana, can you?

A. Well, that is marijuana. That is cannabis. Whether it is the sativa or the indica—I might explain to you. I think you are confused.

Q. I don't want any explanation, sir. I am just asking you to tell me again—you have already told us you can't tell. Now, look at it again.

A. Can't tell what?

Q. That it is marijuana.

A. I said no such thing.

Q. You said no such thing?

A. That's right.

Mr. Marcus: Just a minute.

Mr. Bender: Read the record.

The Witness: Let's read the record.

Mr. Marcus: Yes; go back and read the record.

(Whereupon, the reporter read the record as follows:)

(Testimony of Meyer I. Goodman.)

“Q. Is this cannabis sativa?

“A. It is impossible to tell which variety it is right now.

“Q. I didn’t ask you which variety it is.

“A. I don’t know.

“Q. You can’t tell whether this is cannabis [298] sativa or commonly known as marijuana, can you?

“A. Well, that is marijuana. That is cannabis. Whether it is the sativa or the indica—I might explain to you. I think you are confused.”

Mr. Bender: Did you hear that, your Honor? The answer was, “Well, that is marijuana.”

The Court: Yes.

Mr. Marcus: You heard it all, did you, your Honor?

The Court: Yes.

Q. (By Mr. Marcus): Do you see the stems growing perpendicular to one another on that plant?

A. All——

Q. Just answer yes or no, please. Do you see it?

A. This is dried marijuana.

Q. I know, but the stems are on there, aren’t they? A. They are dried up.

Q. Look at the stems, will you?

A. All plants shrivel, you see.

Q. Look at the plant, will you?

A. I see it. My eyesight is very good.

Q. That’s fine. Do you see any stems growing perpendicular to each other, as you indicated to the court a while ago? A. At this time, no.

(Testimony of Meyer I. Goodman.)

Q. Do you see the stems on there? Look at it, please. [299] Do you see stems on there?

A. Might I explain to you?

Q. No; just answer.

A. This is not a stalk.

Mr. Marcus: Will your Honor instruct the witness——

The Court: Just answer the question.

Q. (By Mr. Marcus): Do you see the stems growing on that plant? A. No.

Q. You don't see any stems? A. No.

Q. Let me show it to you. You understand, Mr. Goodman, that you are on the witness stand and under oath?

A. Which stems do you mean? I don't understand. I'll explain to you. There are no stems on this particular part. This is one of the fronds. I am trying to explain to you. You refuse to——

Q. Now, look at this.

A. Do you know how wide the main stalk of the hemp plant is? Sometimes three or four inches wide—the main stalk. This is nothing more than a little frond of the end of the plant. This is where the fingers come out. I am trying to show you this.

Q. I understand what you are trying to show us. Do you see where the leaves grow? Do you see any leaves on there. [300]

A. These are dried up leaves.

Q. Dried leaves?

A. Yes; dried up. Dried up leaves.

(Testimony of Meyer I. Goodman.)

Q. The leaves grow on the little branches, don't they?

A. That's right.

Q. You see the branches?

A. These grow as fingers on a hand.

Q. Do you see the little branches there?

A. These are the remains of leaf stalks. That's what they are.

Mr. Marcus: I think the court can see the leaves and can observe the stems.

Q. And the leaves, sir, are growing on the small stems, aren't they?

A. The leaves are attached to the leaf stalks.

Q. I want you to look through this sack here and see if you can find any stems in this entire stalk that have the various branches growing perpendicular to one another.

A. I can't.

Q. You can't, can you?

A. That's right.

Q. Will you look through the——

A. I don't have to look through the entire—— this is dried marijuana. You will not find that condition existing here. This is a fresh plant I was describing before growing [301] in the field.

Q. The only difference between the fresh plant and this plant is that this plant is dry?

A. Or shriveled up; that is right.

Q. Look at the various places where the little stems come out from that.

A. Yes.

Q. Do you see that?

A. Yes.

Q. Do you see them perpendicular to one another?

A. I am trying to state this is not a main stalk.

(Testimony of Meyer I. Goodman.)

Q. Can you answer that yes or no?

A. It is impossible. You don't understand.

Q. Do you see any of the little branches where the leaves are growing perpendicular to one another on there?

A. The perpendicular refers to the main stalk of the plant and the branches coming out of it. And this is a tertiary or quardary diminution of them, your Honor.

Q. Will you answer the question yes or no, please? Do you see any of the branches upon which the leaves are growing here perpendicular to one another? Do you?

A. I can't answer that question for you because it is misleading to the court.

Q. You won't answer that, will you?

A. I will, if you want me to, just to merely say words, [302] I will positively answer you.

Q. You answer the question, Mr. Goodman.

A. Yes.

Q. Do you see any of the branches from this branch? A. From that piece of marijuana?

Q. Yes; growing perpendicular to one another?

A. I do not.

Q. You do not? A. Yes, sir.

Q. Now, you look at this little pile here, sir, and tell me whether or not you are able to discern any leaves on the plant?

A. This is shriveled, dried marijuana.

Q. Please answer the question.

A. Months old.

(Testimony of Meyer I. Goodman.)

Q. Please answer the question, will you? Do you see any leaves on this plant?

A. In the shriveled form, yes.

Q. All right, sir; pick out any one of these and take it in your hand, will you, sir? Now, do you see the shriveled leaves there? A. Yes.

Q. Do you see and are you able to discern any texture from those shriveled leaves?

A. Not in this form. [303]

Q. Do you see any horn-shaped?

A. I didn't say horn. You mean serrated?

Q. Well, I call it horn-shaped. You call it serrated. A. There's a great difference.

Q. All right. Do you see any serrated outline of the leaves that you have examined?

A. Not in this form.

Q. Now, examine all the rest of it there that is in front of you and tell us whether you can discern the serrated form of any leaf on any of that object?

A. I will save the court's time and say it is impossible to do that now.

Q. It is impossible to do it? Now, what other way do you have of ascertaining, besides by looking at it, examining the texture, examining the leaves and by smelling it, from your knowledge of marijuana and you taught in the university, of ascertaining whether or not a certain plant is marijuana or not? A. The very characteristic——

The Court: Just a moment.

(An interruption at this point.)

(Testimony of Meyer I. Goodman.)

The Court: I have to take a phone call. It is time for the morning recess anyway.

(Recess.)

The Court: Have Mr. Goodman take the stand again. [304]

Q. (By Mr. Marcus): Mr. Goodman, is it not a fact, sir, that the parking area of the market is much larger than the parking area of the service station? A. Much larger?

Q. Yes.

Mr. Bender: The Government objects to the question on the ground that it asks for a conclusion of the witness—much larger. It is vague, indefinite and uncertain.

The Court: I will overrule the objection. You may answer.

The Witness: The parking area of the market probably is larger than the parking area of the gas station. It probably is.

Q. (By Mr. Marcus): Do you have any idea as to the width of the entire parking area and the station, that is, the entire lot, which includes the gasoline station of the service station?

Mr. Bender: The Government objects to that question on the ground that it is asking for a conclusion of the witness, his opinion as to whether he has any idea as to the comparative measurements.

The Court: I will overrule the objection.

The Witness: I don't know what the dimensions

(Testimony of Meyer I. Goodman.)

are, but if you have them there I will accept your figures, Mr. Counsel.

Q. (By Mr. Marcus): Well, sir, I didn't make this map and it was given to me, but I will ask you whether or not, [305] in your opinion, the entire width of the service station lot, including the parking area, is approximately 125 feet?

A. That could possibly be so. It probably is.

Q. All right, sir. Now, is it a fact, sir, that the market building alone across the street is 124 feet wide?

A. You mean the entire width of the market——

Q. Building.

A. ——is just one foot less than the entire area?

Q. One foot less than the entire frontage of the parking area of the service station?

A. I don't think it is.

Q. You don't know, do you?

A. I am pretty sure from this parking area——

Q. You are directing your attention now to the service station?

A. To the service station parking area——extends a considerable distance beyond the ending of the market across the street.

Q. Now, sir, is it a fact that the entire area of the parking lot frontage, including the market, is 181 feet?

A. That could quite possibly be so. It is larger. I know that. It is considerably larger than the parking area across the street.

Q. Yes, sir; that is, of the service station?

(Testimony of Meyer I. Goodman.)

A. That is correct; yes. [306]

Q. Now, sir, both market and service station face Beverly Boulevard, do they not?

A. That is correct.

Q. Is it a fact, sir, that from the front of the drive-in on the market, which faces Beverly Boulevard, in a straight line to the rear of the lot is approximately 143 feet?

A. I don't know.

Q. Do you have any opinion at this time with respect to the distance?

A. I don't have any particular opinion. I can't say. If you want me to estimate what I think, it might be over a hundred feet. It probably is.

Q. 143 feet? A. It could possibly be so.

Q. Is there a sidewalk in front of the market?

A. Yes.

Q. And do you have any opinion with respect to the width of that?

A. I don't know what the width of it is.

Q. Do you have any opinion with respect to the distance from curb to curb of Beverly Boulevard at that point?

A. Well, your drawing says 57 feet. That could be so.

Q. If the sidewalks on both sides of the street are 10 feet—— [307]

A. Yes.

Q. ——you would add—— A. 20 feet.

Q. ——20 feet to the 57 feet as the distance between the respective buildings, wouldn't you?

A. That is approximately correct.

Q. Then as between the respective buildings and

(Testimony of Meyer I. Goodman.)

including the street of Beverly Boulevard, you would have approximately 77 feet, wouldn't you?

A. Will you repeat that again?

Q. As between the two buildings, that is, the market building and the service station, including Beverly Boulevard, the distance between those two points would be approximately 77 feet?

A. That would be quite possible.

Q. Now, sir, your car was not parked on the sidewalk, was it?

A. No; it was right there at the edge of the sidewalk.

Q. Right at the edge at the driveway?

A. In the parking area, yes.

Q. Now, from the point of the edge of the building of the service station to the rear of the lot, where you say the cars were parked, would be a distance of 143 feet plus 77 feet, would be approximately 220 feet from where your car was parked to where the other cars were parked; is that correct? [308]

A. Except for one discrepancy which I can point out to you. Our car is parked ahead of the actual building and the gas station, you see, so that it is parked about right here, right at the edge of the curb—right about there.

Q. Yes, but you see, I didn't go back to the building. I only took the sidewalk.

A. No; you added 10 and 67 and made 77 out of it.

Q. Yes; there is a sidewalk here.

(Testimony of Meyer I. Goodman.)

A. That is correct.

Q. So I am only taking to the edge of the sidewalk, and you said your car was not parked on the sidewalk?

A. Not on the sidewalk; right at the edge of the sidewalk.

Q. So you take 10 feet from this sidewalk in front of the service station? A. Yes.

Q. You take the 10 feet of the sidewalk in front of the market, plus the 57 feet, the width of the street itself, you would have 77 feet; is that correct?

A. That is correct.

Q. Plus the 143 feet, or a total of 220 feet from where you were standing?

A. Very possible; yes.

Q. This was 7:30 at night, wasn't it?

A. That is correct. [309]

Q. And, I understand, sir, that you could tell the features of these men who were back of the car and you could identify Mr. Lozoya for that distance of 220 feet at 7:30 at night?

A. It was not difficult at all.

Q. Did you recognize him?

A. I did; yes. I so testified.

Q. All right, sir.

Mr. Marcus: I would ask your Honor at this time if the court could go out in the hallway, because we don't have enough measurement here, and we will mark off approximately the end of the hallway and your Honor could ascertain whether or not

(Testimony of Meyer I. Goodman.)

you could tell features under the lights of this hallway that distance.

Mr. Bender: The Government objects to that request on one ground: It is not a question whether the——

The Court: I will sustain the Government's objection.

Mr. Marcus: That will be all.

The Court: That's all.

Is that all?

Mr. Bender: I have a few additional questions, your Honor.

The Court: All right.

Mr. Marcus: May I ask one more question?

The Court: Yes. [310]

Q. (By Mr. Marcus): Did you see this man have a black eye or bleeding from his face or his ear at the time he was out there talking to you?

A. No, sir. You mean at the gas station?

Q. No; at the market.

A. At the market? No; he didn't. I didn't recognize such a thing.

The Court: Go ahead, Mr. Bender.

Redirect Examination

By Mr. Bender:

Q. Mr. Goodman, did you see the lid on the trunk of the defendant's car go up? A. I did.

Q. Did you see the lid on the Government con-

(Testimony of Meyer I. Goodman.)

vertible go up? A. Yes, sir; I did.

Q. Was there anything between you when you saw the defendant Lozoya carry the bag from the rear of his car to the rear of the Government car?

A. Nothing.

Mr. Bender: No further questions.

Mr. Marcus: Just one question with respect to that.

Recross-Examination

By Mr. Marcus:

Q. There was traffic? [311] A. There was.

Q. Automobiles on Beverly?

A. There was some; yes.

Q. That was between you and what was going on in the other car, wasn't it?

A. There was some traffic traveling up.

Q. That obstructed your vision, didn't it?

A. No.

Q. The cars coming between didn't obstruct your vision? A. Not one bit.

Mr. Marcus: That's all.

Redirect Examination

By Mr. Bender:

Q. Were these cars that were passing—did they stop and remain between you and your vision of the defendant carrying the bag? A. They did not.

Mr. Bender: That's all.

The Court: Is that the Government's case?

(Testimony of Meyer I. Goodman.)

Mr. Bender: No, your Honor; we have two additional witnesses.

The Government at this time renews the motion with respect to the proposed exhibits.

The Court: I will let Exhibit 1 be received at this time rather than have further argument. It is for the court [312] to pass on the matter. I will let it be received.

Mr. Bender: And also Exhibits 1-A and 1-B, your Honor.

The Court: That's right. I will allow them to be received in evidence.

(The exhibits referred to, marked Plaintiff's Exhibits 1, 1-A and 1-B, were received in evidence.)

The Court: Where is the next witness?

Mr. Bender: I believe he is in the attorneys' cloakroom, your Honor.

The Court: Can you get him?

Mr. Bender: Yes, sir.

MICHAEL GULLON

called as a witness for the plaintiff, being first sworn, was examined and testified as follows:

The Clerk: State your full name, please.

The Witness: Michael Gullon.

Direct Examination

By Mr. Bender:

Q. Mr. Gullon, what is your full name?

A. Michael Gullon.

(Testimony of Michael Gullon.)

Mr. Bender: Your Honor, to make certain the exhibits of the Government are in order, it is my understanding that Government's Exhibit 1 for identification, Government's Exhibit 1-A and Government's Exhibit 1-B are now in evidence.

The Court: That is right. [313]

Mr. Bender: And that Exhibit 2 is in evidence?

The Court: That is right.

Mr. Bender: And it has been signed by the court?

The Court: That is right.

Q. (By Mr. Bender): What is your present profession or occupation?

A. Federal Narcotic Agent, U. S. Treasury Department.

Q. For how long have you been so employed?

A. Three years, sir.

Q. Directing your attention to on or about May 17, 1956, and to the vicinity of the Beverly Ranch Market at Montebello, California, were you present at the Beverly Ranch Market on that date?

A. Yes, sir; I was.

Q. Approximate date. Approximately what time on May 17th were you present at the Beverly Ranch Market?

A. Oh, from about 7:00 p.m. to about 8:00.

Q. What time did you arrive at the Beverly Ranch Market?

A. I arrived there some time between 6:30 and 7:00.

Q. Was there anyone else with you at the time?

(Testimony of Michael Gullon.)

A. Yes, sir; Agent Freeman was with me.

Q. What did you do upon arrival?

A. Agent Freeman and myself, we took positions close to the market on Beverly Boulevard. [314]

Q. Directing your attention to the blackboard, the diagram that has been drawn here, north being at the top, south at the bottom, east to the right and west to the left, and this is indicated as Beverly Boulevard running easterly and westerly, would you point out the position of the Beverly Ranch Market?

A. (Stepping down to the blackboard.) The market is in the southeast corner of the intersection.

Q. And you have pointed to the chalk indication of the letter M there, have you not?

A. That is correct, sir.

Q. Did the market also have a parking lot or parking area?

Mr. Marcus: Can we stipulate to his testimony with respect to the parking area and so forth, the same as the other?

Mr. Bender: I will cut it much shorter, counsel.

Q. Did it? A. Yes; it was.

Q. Where were you? What position did you take up with reference to the market and the parking area of the Beverly Ranch Market?

A. I was on the sidewalk section east of the market in this position right here.

Q. On which side of Beverly?

A. I was on the east side of Beverly. [315]

(Testimony of Michael Gullon.)

Q. You have indicated Beverly as running easterly and westerly?

A. Oh, I see. The southern part of Beverly.

Q. In other words, then, you were on the sidewalk which is on the same side of the street as the Beverly Ranch Market?

A. That's correct.

Q. But you were easterly of the actual Ranch Market itself?

A. That's correct.

Q. Approximately how far were you from where you stood on the sidewalk to the most southerly extremity of the Ranch Market parking area—your approximation?

A. I don't know the exact distance, but it could have been anything between 80 to 100 feet.

Q. Now, what did you observe occur on that date after you took up your position there on the sidewalk easterly of the Beverly Ranch Market—what happened?

A. Some time around 7:30 the defendant, who is in the courtroom—

Q. Would you point out the defendant?

A. Yes, sir; the gentleman with the glasses.

Mr. Bender: Mr. Lozoya, please stand.

(The defendant stands.)

Q. (By Mr. Bender): Is this the gentleman you refer to? [316]

A. That's correct, sir.

Q. Thank you.

A. The defendant, I observed, approached the intersection from the west side. He stopped for a little while. He was driving a Chevrolet, as I recall.

(Testimony of Michael Gullon.)

Q. Excuse me, Mr. Gullon, but by that you mean he approached in a Chevrolet going easterly on Beverly? A. That is correct.

Q. In an easterly direction, and he approached the intersection of this Beverly Ranch Market. What did he do then?

A. He stopped for a red light. He then made a right turn.

Q. On what street?

A. On Poplar Street and entered the market through the west side.

Q. After he made the right turn on Poplar Street, did he remain in your vision?

A. No, sir; he was out of my vision from this corner until the time I observed the car in the parking lot itself on the easterly side of the parking lot.

Q. What did the car do after you observed it again on the easterly portion of the parking lot? Where did it go?

A. The defendant stopped the automobile in front of Agent Ramirez' automobile that was already parked there.

Q. So which direction, then, was the [317] defendant's automobile facing at the time it first stopped?

A. As I recall, he was facing east.

Q. And which direction was Agent Ramirez' automobile facing at this time?

A. It was facing north. He was parked. He backed his car against the embankment here at the rear of the parking lot.

(Testimony of Michael Gullon.)

Q. What occurred then?

A. I observed the defendant stopped his automobile. Agent Ramirez left his automobile and talked to the defendant. He seemed to be talking to him. The defendant then backed up his car and he was parallel with the Government car.

Q. In other words, he parked it in a parallel position with the Government car?

A. That's correct, sir.

Q. Approximately how much distance separated the two automobiles?

A. Oh, about this much (indicating).

Mr. Marcus: Four feet?

Mr. Bender: Four or five feet.

The Witness: Four or five feet.

Mr. Marcus: Well, that is less than four feet. Do that again, please.

The Witness (Indicating): Well, I don't know, some distance about this wide. [318]

Mr. Marcus: Would your Honor give an estimate on that for the record?

The Witness: It is about this distance.

Mr. Marcus: Three feet.

The Court: Well, would you say about three? Wouldn't you?

Mr. Marcus: That is correct; about a yard.

Q. (By Mr. Bender): About how many feet do you think it was, Mr. Goodman?

Mr. Marcus: Not what he thinks. He has already indicated what it was.

The Court: How much do you think it was?

(Testimony of Michael Gullon.)

Well, we have it, I think. Go on to the next question.

Q. (By Mr. Bender): What happened then?

A. I then observed the defendant leave his automobile again and engage in a conversation with Agent Ramirez and after a few minutes elapsed or some time like that, I observed the defendant walk to the rear of his automobile that was parked there and I lost him from view for a second.

I then for the next 30 seconds observed the defendant carrying a big brown sack to the rear of Agent Ramirez' car—automobile. I could see part of the trunk of Agent Ramirez' car lifted and I observed the defendant, he was in a way of a hunch, carrying the bag to Agent Ramirez' car.

After that the trunk of the Ramirez car, the door of it [319] was locked again or placed down, and then I observed the defendant talking again with Agent Ramirez.

At the prearranged signal, which was a banana peel to be thrown to the ground by Agent Ramirez, I ran between the two cars and I arrested all three persons in there.

Q. You say you ran between the cars?

A. Well, I ran from the sidewalk.

Q. In a southerly direction?

A. Yes, sir; parallel to the wall of the market, and then I went and ran between the two cars, because at that time the defendant and Agent Ramirez and a special employee were almost between the two cars talking.

(Testimony of Michael Gullon.)

Q. In which direction was the defendant Lozoya facing at this time?

A. The defendant was facing south.

Q. In other words, he had his back to you?

A. That is correct.

Q. Which direction was Agent Ramirez facing?

A. Well, Ramirez was at an angle. He was facing this area this way. He could see me coming, though.

Q. Sort of a northwesterly direction?

A. Northwest direction; that's right.

Q. What did you do upon arriving in the vicinity of the three persons?

A. I arrested all three persons there at gun point. I identified myself as a Federal Narcotic Agent, and they [320] were all placed under arrest.

Q. While you were still back on the sidewalk, that easterly portion of the Beverly Ranch Market proper, who was with you, if anyone?

A. Agent Freeman was with me.

Q. What did he do before he proceeded to go forward in a southerly direction to make the arrest? What did he do? Where did he go?

A. Well, Agent Freeman was to go through the market itself and exit through the rear door of the market.

Q. Then he had split from or left you at some time, did he not? A. That is correct, sir.

Q. And approximately where, in the point of your standing on the sidewalk, with reference to the time that you ran forward, about what time did

(Testimony of Michael Gullon.)

he depart? A. Departed about the same time.

Q. Approximately the same time?

A. Approximately the same time.

Q. When you were running forward, did you see Agent Freeman?

A. No; I didn't, sir. I didn't see him until the time after I made the arrest, and as soon as I made the arrest I observed Agent Freeman to my right and his assistant, and a few seconds later I observed Agent Goodman came up and [321] Agents Miller and Cantu.

Q. Would you relate what occurred at the time of the arrest? What was said, if you recall, by everyone who was present at this time and in the presence of the defendant?

A. As I stated before, I stated I was a Federal Narcotic Agent, showed them my badge. I then—oh, I then waited a few seconds. Agent Freeman came up, and Miller and Cantu and Goodman. Agent Goodman, as I recall, asked Agent Ramirez whose car was that, as he pointed to the Government car. Agent Ramirez stated something to the effect that it belonged to his girl friend, something to that effect. Agent Goodman also asked for the keys to the defendant's automobile, and the defendant handed them to him. Agent Goodman made some statement to the effect that there was nothing in the car, as he looked through it. He made an attempt to start the car and it wouldn't start. Agent Miller and I then took the defendant, who was

(Testimony of Michael Gullon.)

handcuffed by this time, into the other Government car. The special employee was also arrested.

Q. Mr. Gullon, was anything done with the 10-pound bag that you say you saw the defendant Lozoya carry over from the trunk from the back of his car——

Mr. Marcus: Just a moment. He didn't say he saw anybody carry a 10-pound bag.

Mr. Bender: Strike the 10-pound. [322]

Q. Was there anything done with the bag you testified you saw the defendant Lozoya carry from the rear of the Government car?

A. Yes; Agent Goodman seized the bag from the Government car, and when I left the area he had it in his possession, as far as I recall.

Q. You didn't hear any conversation, then, between Goodman and the defendant concerning the bag?

A. Agent Goodman, as I recall, he cursed the defendant. He asked him a couple of times about the bag, and the defendant acted—he stated, “What are you talking about?” And Agent Goodman pointed to the bag. And he says, “I don't know what you are talking about.” And Agent Goodman used the words and said, “God damn it,” and said, “This bag over here.” And the defendant just kept saying, “I don't know what you are talking about.”

Q. Did you make any examination of the contents of the bag which you saw the defendant Lozoya carry over to the car?

(Testimony of Michael Gullon.)

A. I did some time later in the Bureau of Narcotics office.

Q. Did you place your initials on any of the paper bags? A. I believe I did.

Q. I show you Government's Exhibit 1-B, which is the outer carton and box, and Government's Exhibit 1, which consists of a brown bag—— [323]

Mr. Marcus: If the signatures are on there, I will stipulate that he put his signatures on there when he got down to the Federal Building. Are they on there, or aren't they?

Mr. Bender: There are so many signatures, I don't know.

The Witness: This is my signature.

Q. (By Mr. Bender): That is your signature on one of the paper bags?

Mr. Marcus: It is stipulated that he put his signature on the bag at the Federal Building.

The Court: All right.

Q. (By Mr. Marcus): Did you examine any of the contents of any of the bags?

A. Yes, sir; I did.

Q. What did it appear to resemble?

Mr. Marcus: Let's have a foundation, first. It is objected to on that ground, your Honor, where he examined it.

The Court: All right.

Mr. Bender: He is speaking of the examination at the Federal Building.

Mr. Marcus: That's all right. He didn't say that he did, but I will take it as that.

(Testimony of Michael Gullon.)

The Court: Where did you examine it?

The Witness: The evidence was examined by me at the Federal Building at the Bureau of Narcotics office. [324]

The Court: All right.

Q. (By Mr. Bender): What did the substance which you have examined appear to resemble?

Mr. Marcus: There is no foundation for that—appears to resemble what is in there; that is something else.

Mr. Bender: He can testify that it resembles something else.

Mr. Marcus: You have no foundation as to what it appears to resemble, unless he testifies that he knows what he is referring to, what it may resemble.

The Court: Yes; I'll sustain the objection. Lay a further foundation.

Q. (By Mr. Bender): Mr. Gullon, have you on other occasions observed marijuana in its dry state?

A. Yes, sir; on many occasions.

Q. Did you make any mental comparison between your prior experience of observing marijuana on these numerous occasions and the substance which you saw in the paper sacks which are Government's Exhibit 1 in the Federal Building?

A. Yes, sir; I did.

Q. Did the substance which you observed in the paper sacks appear to resemble any substance which you had seen before?

A. Yes, sir; it did.

Q. What substance? [325]

A. Marijuana.

Mr. Bender: You may cross-examine.

(Testimony of Michael Gullon.)

Cross-Examination

By Mr. Marcus:

Q. Mr. Gullon, as I understand, when you saw a banana peel drop, you started to run?

A. Yes, sir; I did.

Q. On a prearranged signal you ran back to the rear of the lot?

A. That is correct, sir.

Q. What was the first thing you said?

A. "Federal Narcotic Agent. You are under arrest."

Q. You didn't know what was in the sack at the time, did you? Or did you?

A. The prearranged signal was——

Q. Did you know what was in the sack when you ran back and said, "I am a Federal Narcotic Agent. You are under arrest"? Did you know what was in the sack?

A. No, sir; not at that time.

Q. Not at that time? You made an arrest before you knew what was in the sack, didn't you?

A. By prearranged signal I made an arrest.

Q. I am talking about what your knowledge was at the time that you made the arrest. You didn't know what was in the sack, did you? [326]

A. The signal meant it was marijuana.

Q. You didn't see the sack opened before you got there, did you?

A. It could have been opened.

Q. Not what it could have been. Was it opened while you were observing it?

(Testimony of Michael Gullon.)

Mr. Bender: The Government objects to that question on the ground that it asks for a conclusion, your Honor.

The Court: I will overrule the objection.

Mr. Marcus: How could it be a conclusion if I asked him what he saw?

The Court: I overruled the objection.

Q. (By Mr. Marcus): Did you see anybody open that sack? A. No, sir; I did not.

Q. So you didn't see Officer Ramirez open the sack, did you?

A. I saw him bend down and do something with it.

Q. I didn't ask you whether you saw him bend down. I asked you if you saw him open the sack?

A. No, sir; I did not.

Q. You didn't see him take out anything from the sack, did you? A. No, sir; I did not.

Q. Who put the sack from one car to another?

A. The defendant. [327]

Q. The defendant?

A. Yes; that is correct.

Q. And when it got into the Government car, the hood was put back down, wasn't it?

A. Not right away, sir.

Q. I didn't say right away. I said the hood was put down? A. A short time later; yes.

Q. By the time you arrived there, after you started to run, the hood was down, wasn't it?

A. That is correct, sir.

Q. And who had the key?

(Testimony of Michael Gullon.)

A. What key, sir?

Q. The key to the Government car?

A. I don't know, sir.

Q. How did you open the trunk after it was down?
A. I didn't open the trunk, sir.

Q. Who opened it?

A. Agent Goodman, I believe, sir.

Q. Were you there when he opened it?

A. Yes, sir; I was present.

Q. How did he open it?

A. I don't recall, sir.

Q. Didn't he have to go to the car and take the key out and open the trunk? [328]

A. What car, sir?

Q. The Government car I am talking about, the one that he opened. Didn't you see him go to the car, take the key out and go back and open the trunk?

A. I don't recall, sir. I don't recall that.

Q. You don't recall that? Did you see him open the trunk?

A. I recall him lifting the trunk, but I don't recall——

Q. Did you see how he opened the lock on the back of the Government car?

A. At that time, sir, I was in charge of a prisoner. I was paying attention to the prisoner.

Q. I am asking you when you saw the trunk lift up—you testified on direct examination that you saw the trunk open?
A. Yes; it was open.

(Testimony of Michael Gullon.)

Q. That Officer Goodman took the stuff out and took it into his custody; didn't you?

A. That is correct.

Q. Tell the court how you saw him open the trunk?

A. I don't recall how the trunk was opened, sir.

Q. Did he have a key in his hand?

A. I don't recall, sir.

Q. You don't remember that?

A. No, sir. [329]

Q. All right. You had the defendant in custody, didn't you?

A. Yes, sir; he was under arrest.

Q. You told him he was under arrest for violation of the Narcotics Act, didn't you?

A. No, sir; I didn't tell him that.

Q. What did you tell him—your exact words?

A. I told him I was a Federal Narcotic Agent; he was under arrest.

Q. Would he be under arrest at that time, you believed, for narcotics? Is that right?

A. That was the purpose of it, sir.

Q. Then you didn't know at that time that there was any narcotics at all in the sack, did you?

A. No, sir; I didn't look in the sack yet.

Q. And nobody else in your presence had looked in that sack at that time, had they?

A. I don't know that, sir.

Q. Well, in your presence, what you saw, you didn't see anybody open the sack?

A. I don't recall whether they did or not.

(Testimony of Michael Gullon.)

Q. Well, at least at the time you told him that he was under arrest and that the others were under arrest, you didn't know what was in the sack at all, did you?

A. No, sir; I hadn't looked at the sack. [330]

Q. So you made an arrest not knowing what was in the sack; is that right?

A. I had an idea what was in the sack, sir.

Q. I don't care what ideas you might have had. I asked you whether or not you knew. You said you didn't know. So you made the arrest at the time without even knowing what was in the sack?

A. I made the arrest after a signal by another Agent was given that it was marijuana.

Q. Yes, but you didn't see anybody open anything or examine anything at that time, did you? Did you?

A. I'm thinking, sir.

Q. I see.

A. No, sir. If it was opened, I don't recall who did it.

Q. Well, you knew Johnny Villas, didn't you, the other man that was there—you knew him, didn't you?

A. No, sir; I did not.

Q. You had never seen Johnny Villas before? Look, we already have established here, so you don't have to deny that this special employee that you talked of a while ago, his name is Johnny Villas. I don't want to put you on the spot, Mr. Goodman, but he has already been identified and his name is Johnny Villas and I happen to know him because I represented another defendant in another case.

(Testimony of Michael Gullon.)

With that [331] explanation, do you know Johnny Villas? A. Yes.

Q. I don't want you to commit perjury on this witness stand.

Mr. Bender: The Government objects to this line of questioning on the ground that it is immaterial.

The Court: The latter statement may go out. Go ahead and answer the question.

Q. (By Mr. Marcus): Johnny Villas was there, wasn't he?

A. You mean the other person that was arrested with the defendant?

Q. The "special employee" you called him.

A. That is correct.

Q. That was Johnny Villas, wasn't it?

A. I didn't know that, sir.

Q. You didn't know his name?

A. No, sir; I did not.

Q. How long before that had you seen him?

A. I observed the special employee about 15 minutes before he arrived with the defendant.

Q. Well, you knew Ramirez, didn't you?

A. Beg your pardon?

Q. You knew Agent Ramirez before this?

A. Yes; I did.

Q. And you already had the picture in your possession [332] of Lozoya, hadn't you?

A. That is correct.

Q. So the other one would have to be the special agent? A. Oh, yes, sir.

(Testimony of Michael Gullon.)

Q. That is just for the moment.

A. I don't understand what you mean.

Q. That didn't take much of a mental deduction to figure out who the other fellow was, did it?

A. No, sir.

Q. So you knew the other fellow was a special employee at the time?

A. I was told about it 15 minutes before he arrived.

Q. Well, whether you were told or weren't told, you knew Ramirez and you knew Lozoya, so the third one would have to be the special employee, wouldn't he?

A. Not necessarily, sir.

Q. Did you see him in the car?

A. Who, sir?

Q. The special employee?

A. Yes, sir; I did.

Q. You had a pretty good idea who he was?

A. Yes, sir; I did, at that time.

Q. You told Ramirez he was under arrest, too?

A. All three persons were placed under arrest.

Q. You remember Ramirez saying that the stuff in the [333] car, he didn't know how it got in there; the car belonged to his girl friend; you remember that, don't you?

A. There was some conversation to that effect, sir, when he was questioned by Agent Goodman.

Q. Agent Goodman was putting on an act there at the time, wasn't he?

A. That is correct, sir.

Q. And he was questioning Ramirez?

(Testimony of Michael Gullon.)

A. Yes, sir.

Q. And Ramirez says, "I don't know how that got into the car," didn't he?

A. He probably did, sir.

Q. Well, you heard him say that, didn't you?

A. Well, I couldn't tell you exactly the full conversation or the exact words; something to that effect.

Q. Was that substantially his language, "I don't know how it got into my car"?

A. Probably; yes, sir.

Q. Then he was asked by Agent Goodman, "Whose car is that?"

A. That is correct.

Q. And Agent Ramirez said, "That car belongs to my girl friend. You will have to ask her how the stuff got into the car"; isn't that right?

A. No, sir; it is not right. What I recall is [334] that Agent Ramirez stated it belonged to his girl friend.

Q. The car belonged to the girl friend?

A. That is right, sir.

Q. They then asked Mr. Ramirez how it got in there—I should say Mr. Lozoya, didn't they?

A. I believe they did; yes, sir.

Q. Who asked him?

A. Agent Goodman was asking most of the questions.

Q. What did Agent Goodman say?

A. As I recall, he questioned the defendant regarding the bag.

Q. What did he ask him about the bag?

(Testimony of Michael Gullon.)

A. Something to the effect like, "What about this bag here?"

Q. "What about this bag here" that had come out of the government car?

A. That is correct, sir.

Q. And then what did Lozoya say to that?

A. He says, "What bag?"

Q. "What bag?" And then what did Agent Goodman say?

A. He pointed to the bag and said, "This one here."

Q. And then what did Lozoya say?

A. He still said, "What bag?"

Q. Did he say he doesn't know anything about the bag?

A. He said something to the effect, "I don't know what [335] you are talking about."

Q. "I don't know what you are talking about." Then what did Agent Goodman say?

A. Still questioning him about the bag, he said, "The bag you put in the trunk."

Q. What did Lozoya say about it?

A. I don't recall, sir. He just kept saying, "What bag?"

Q. He denied he had taken any package out and put it in the other car; that he knew anything about the bag all of the time?

A. He made denials all the time; yes.

Q. And then Agent Goodman got mad and started cussing?

(Testimony of Michael Gullon.)

A. Agent Goodman did say, "God damn it" in English.

Q. Well, he started cussing, didn't he?

A. All I recall is the words, "God damn it."

Q. And then some people came up from that area, didn't they, and asked Mr. Goodman not to use any vile, abusive language because of the children around there; don't you remember that?

A. No, sir; that is not true.

The Court: Well, it is noon.

Mr. Marcus: Just one more question, your Honor.

The Court: All right.

Q. (By Mr. Marcus): You talked to Agent Goodman, didn't [336] you?

A. Yes; I talked to Agent Goodman.

Q. When did you talk to him?

A. Many times.

Q. Since yesterday? A. Yes, sir.

Q. Where were you when you talked to him?

A. In the building.

Q. In the offices of the Narcotics Department?

A. Yes, sir.

Q. You talked about what had happened in the courtroom here, didn't you?

A. We talked about everything except his testimony.

Q. Well, you talked about everything except his testimony?

A. Everything as to official business that we conduct every day, sir.

(Testimony of Michael Gullon.)

Q. You talked to him about what happened out there that night, didn't you—that is, on May 17th?

A. I talked to Agent Goodman.

Q. You talked to him since yesterday as to what happened on May 17th?

A. I have talked to him in regard to the market, in regard to——

Q. Where he was standing? [337]

A. No, sir. Like I stated——

Q. Well, you talked about the market. What else did you talk about?

A. In regard to when we would get through with his testimony and when I would come up to testify.

Q. Let's talk about the market. What did you talk about the market?

A. Something to the effect which way was north.

Q. Did you talk about how wide the market was?

A. No, sir.

Q. Anything else about the market?

A. No, sir; just one question.

Q. Did you talk about the width of the parking lot?

A. No, sir.

Q. What else did you talk about?

A. That was all I recall.

Q. Well, the market concerned this case, didn't it?

A. Oh, yes, sir.

Q. What else did you talk about when you were talking about the market?

A. Just which way was north.

Q. Did you talk about the service station and which way was north?

A. No, sir.

(Testimony of Michael Gullon.)

Q. Did you talk about where you were [338] standing? A. No, sir.

Q. Well, you did have a conversation with respect to the facts of this case pertaining to the market since yesterday, didn't you?

A. Oh, yes, sir.

Q. And that took place up in the offices of the Narcotics Bureau?

A. Probably did, sir; yes, sir.

Q. You talked to him out in the hallway this morning, didn't you?

A. Yes; I talked to him this morning.

Q. You talked to him about the facts of this case this morning, didn't you?

A. No, sir; I did not.

Q. What did you talk about this morning?

A. We were talking about a trial that was coming up.

Q. Nothing about this case this morning?

A. No, sir.

Q. That took place yesterday?

A. That is correct, sir.

Q. That is after he testified in the afternoon?

A. I don't recall when it was, sir.

Q. Before you leave——

Mr. Bender: May the record show that counsel stated there was going to be one more [339] question?

Mr. Marcus: The record shows that.

Q. Will you tell us about how far it is from where you are seated on the witness stand to the

(Testimony of Michael Gullon.)

back of this wall where I am standing now—how far is it back here?

A. I don't know, sir. It is pretty hard to tell.

Q. Give us an estimate of the distance, your best estimate. Can you estimate it, please?

A. Do you mind if I think, sir? It might take some time.

Q. While you are thinking, can you tell me what this is? What is this?

A. You are holding a brown-colored object in your hand, sir.

Q. This is a brown colored?

A. Dark brown from over here; that is right.

Q. Let me bring it up to you. What color is that?

A. It still appears brownish, but with a greenish color in it now.

Q. I am up facing you. What color is that?

A. It is a combination of green and brown in it, sir.

Q. Did you see this bag at any time before today? A. Could I see the bag, sir?

Q. Just look at it from where you are, and you are only at least ten feet, approximately ten feet from it.

A. There are thousands of bags like that in town, sir. [340] If I find my initials, it is the same bag I saw that day.

Q. Not whether it is your initials. I am trying your memory now. Is that bag green?

A. A combination of green and brown.

Q. What color is all this area in here (indicating)?

(Testimony of Michael Gullon.)

A. To me it seems like a very dark green-brownish appearance from a distance.

Q. Did you ever see this before today?

A. Like I stated, I have seen many bags like that before.

Q. Can you tell us, yes or no, whether you have seen it before today?

A. I have seen many bags like that before, sir.

Q. Have you seen this bag before today? Just yes or no or you don't know.

A. I don't know what you refer to, sir.

Q. I know you don't. Just tell me what your best memory is as to whether or not you have seen this bag before today?

Mr. Bender: The Government objects on the grounds that this question has been asked four or five times and he has answered.

Mr. Marcus: He is only ten feet from me now.

Mr. Bender: He wants to inspect the bag.

Q. (By Mr. Marcus): Can you, yes or no? [341]

A. Can I do what?

Q. You can answer it yes or no or I don't know.

A. To what?

Q. To my question as to whether or not you have ever seen this bag before?

A. I have seen many bags like that before, sir.

Mr. Marcus: Your Honor—

The Court: Just answer yes or no or you don't know.

The Witness: Yes; I have seen bags like that before.

(Testimony of Michael Gullon.)

Q. (By Mr. Marcus): That still doesn't answer the question. Have you ever seen this bag before?

Mr. Bender: Your Honor, I submit the witness should be permitted to inspect the object before he is asked to answer whether he can identify it or not.

The Court: Answer the question. Can you answer the question?

The Witness: I have to inspect the bag, your Honor.

Q. (By Mr. Marcus): Then you can't tell from where you are seated whether you have seen this bag before or not? Is that the answer?

A. No; I have seen a bag before like that.

Mr. Marcus: That is all.

May the record show that this is Government's Exhibit 1?

Mr. Bender: A portion of Government's Exhibit 1.

Mr. Marcus: Yes; just the bag. [342]

The Court: All right.

We will recess. Make it 2:00 o'clock. That's all for the record.

Mr. Marcus: If the court please, would you be kind enough to instruct this witness not to discuss the evidence in this case with anyone else?

The Court: Yes, the witness is instructed not to discuss the evidence.

Mr. Marcus: Except you, Mr. Bender.

The Court: With anyone except the attorney.

(Noon recess.) [343]

Thursday, July 19, 1956—2:00 P.M.

MICHAEL GULLON

called as a witness for the plaintiff, having been previously sworn, resumed the stand and testified further as follows:

Cross-Examination

(Resumed)

By Mr. Marcus:

Q. You testified upon direct examination that part of the time your view was obstructed with respect to the other two cars; is that correct?

A. No; that is not correct.

Q. You could see everything that was going on to the rear of those cars at all times?

Mr. Bender: The Government objects to the question on the grounds that it asks for a conclusion of the witness that he could see everything that was going on behind the cars.

The Court: I will overrule the objection. He may answer.

Mr. Marcus: I'll reframe it, your Honor.

Q. Did you see everything that was going on to the rear of those two cars?

A. I saw what I testified to, sir.

Q. Well, you testified, did you not, that your view was obstructed part of the time with respect to the persons [344] and their activities to the rear of those two cars?

A. That is correct, sir.

Q. Is that correct?

A. That is correct.

Q. What obscured your view?

(Testimony of Michael Gullon.)

A. The position of the car.

Q. You mean part of the car obscured your vision because of its position?

A. That is correct.

Q. The front of the car was facing toward you, was it not?

A. That is correct.

Q. The body of the car was facing toward you, was it not?

A. I don't understand that part about the body. What part of the body?

Q. Well, I mean the top of the car, the side of the car, the fenders?

A. Well, the car was facing me.

Q. That was a cause of obscuring your vision, too, wasn't it?

A. As to what happened to the rear of that certain car.

Q. Is that correct?

A. That is correct, sir. [345]

Q. You said that the car was separated about three or four feet?

A. I didn't say the distance. I measured it (indicating). You people took it for granted.

Q. Just measure it again.

A. (The witness indicating.)

Q. That is all that separated the two cars?

A. About that much; yes, sir.

Q. How far away were you from the rear of the two cars? Well, let's lead you a little bit here. Is it a fact, sir, that you were at least 143 feet from those two cars?

(Testimony of Michael Gullon.)

A. I couldn't tell you the distance, sir. Like I said before, anything between 80 to a hundred feet.

Q. You were standing on the sidewalk up in here some place?

A. You are pointing to the street, sir. I was in the——

Q. Well, on the sidewalk?

A. I was on the sidewalk and sometimes in the parking lot itself. I would be walking up and down. I never was in a standing position at all during the whole transaction.

Q. You were toward the front of the building, were you not, sir?

A. I was at the corner of the building; not in front of it.

Q. Well, the corner of the building, that faces on [346] Beverly; is that correct?

A. Like I said before, sir——

Q. I don't know what you said before. Now I am asking you the question: Were you on the corner of the building that was facing Beverly?

A. No; the corner was facing—the eastern part of the building adjacent to the wall.

Q. That is the wall that ends on Beverly, isn't it? This is Beverly Boulevard right here?

A. Yes.

Q. This is the wall you are talking about?

A. That is correct, sir.

Q. And you were walking up and down this sidewalk and on that sidewalk and on the entrance of that parking lot, weren't you?

(Testimony of Michael Gullon.)

A. That is correct, sir.

Q. So you were up in this area on the sidewalk and near the wall at the time that this transaction was supposed to have taken place?

A. That is correct, sir.

Q. This car was at an angle from you, wasn't it?

A. No, sir; it was not at an angle.

Q. Well, from where you were standing up in here, the cars were parked in the rear, weren't they?

A. In the rear of what, sir? [347]

Q. At the rear of the parking lot?

A. They were to the——

Q. Were they at the back of the parking lot? Let me put it that way.

A. They were at the back of the parking lot in the eastern section of the parking lot.

Q. We'll come to that in just a moment. They were at the rear of the lot. I think you said there was a log back there?

A. I didn't mention any log, but they were at the embankment—there is a sort of embankment there.

Q. That is at the rear of the lot, isn't it?

A. That is correct, sir.

Q. That was to the rear of the building, was it not? A. Yes; that would be the rear part.

Q. Isn't it a fact that the distance is approximately 143 feet from the rear of the lot to the sidewalk?

A. I have never measured the distance, sir.

Q. I know you haven't. I'm asking, is it approxi-

(Testimony of Michael Gullon.)

mately that distance? A. I don't know, sir.

Q. Now, there are homes along in here, or courts, aren't there, right along that walk there?

A. I believe so.

Q. Did you see people back there that [348] evening? A. Yes, sir; I saw people approach.

Q. Did you see any people you recognize in the hall here that were there that evening?

A. No, sir; I do not.

Q. After you put this man under arrest, did you get in the car with him? A. What car, sir?

Q. Any car? I didn't say what particular car. Did you get in a car with the man after you placed him under arrest?

A. Yes, sir; he was placed in the government car. He was then transported to the Federal Building.

Q. Were you with him? A. Yes, I was.

Q. All of the time? A. Yes, sir.

Q. Who else was along with you?

A. Agent Miller, Bureau of Narcotics.

Q. This boy kept maintaining he didn't know anything about that, didn't he?

A. That is correct.

Q. You got him down to the building here. Where did you take him?

A. We took him to our office on the 17th floor and he was taken to the interrogation room. [349]

Q. Have you got an interrogation room, too?

A. Yes.

Q. How long have you been with the Narcotics

(Testimony of Michael Gullon.)

Department? A. Three years, sir.

Q. Did you talk to him in Spanish?

A. There was some words mentioned in Spanish, but I never had a full conversation in Spanish.

Q. Was Agent Miller with you, too?

A. Not all of the time.

Q. I didn't ask you if it was all of the time. Was he with you?

Mr. Bender: Your Honor, the Government requests that counsel make his question more definite. It has not been stated here what time he is speaking of.

Mr. Marcus: I am going to develop it. I am just asking him if he was with him. I will ask him when as soon as I find out if he was alone or not.

Q. Was he with you that evening?

A. What part of the evening?

Q. At any time during that evening, was he with you?

A. Yes; at the time we took the defendant to the Government car, Agent Miller was driving.

Q. Was he with you when you got to the office here?

A. Yes; Agent Miller was with me. [350]

Q. When you first saw him, did he have a black eye?

A. No, sir; he did not.

Q. Did he have any lacerations about his head or about his body that you could see?

A. No, sir; he did not.

Q. You took him up to the interrogation room?

A. Yes, sir.

(Testimony of Michael Gullon.)

Q. He continued to maintain his innocence, didn't he?

A. He continued to deny anything; yes, sir.

Q. Then who struck this defendant?

A. I did, sir.

Q. You're a Government officer, aren't you?

A. That is right, sir.

Q. And you are under instructions not to put a hand on the prisoner, aren't you?

A. We are under instructions to protect ourselves at all times.

Q. You are instructed not to beat a prisoner?

A. We are instructed to protect ourselves.

Q. When did you strike him? When was this?

Was this in the interrogation room?

A. That is correct, sir.

Q. Who was there at that time?

A. It was only the defendant and myself.

Q. Just the two of you? [351]

A. That is correct.

Q. There were officers coming in and out all of the time, weren't there?

A. Yes, sir; that is correct.

Q. And there were a lot of other officers in the adjoining room, weren't there?

A. As I recall, there was.

Q. Well, Officer Goodman was there, wasn't he?

A. Agent Goodman——

Q. Goodman?

A. ——and I believe Agent Cantu——

Q. Agent Cantu?

(Testimony of Michael Gullon.)

A. —were with Agent Ramirez.

Q. Agent Ramirez? You had four or five officers there, did you not?

A. At least three that I can remember right now, sir.

Q. And each of you took turns to talk to him or examine him or interrogate him, didn't you?

A. No, sir.

Q. You're the only one that interrogated him?

A. I don't know what the other Agents did, sir. I can testify to what I did, sir.

Q. Well, he was in a room by himself; is that correct? A. That is correct, sir.

Q. When you brought him to the building here, didn't [352] you tell him, "Why don't you try to escape, you son of a bitch, and we will have this case over with"? A. No, sir; I never did.

Q. Did you use words to that effect?

A. I never did, sir.

Q. Is it a fact, sir, that you used vile and abusive language toward him in the interrogation room?

Mr. Bender: The Government objects to the question on the ground that it calls for a conclusion of the witness, as to whether his language was vile and abusive, your Honor.

The Court: Yes; I'll sustain the objection.

Q. (By Mr. Marcus): Did you tell him, "You son of a bitch, you had better talk or we will finish you off in this room"?

A. No, sir; I never did.

(Testimony of Michael Gullon.)

Q. What did you tell him when he refused to do any talking?

A. That was his right to refuse. I didn't tell him anything.

Q. I know it is his right, but what did you tell him?

A. I kept on talking to him.

Q. What did you say to him there?

A. I kept on asking him in regard to the sack of marijuana and to his connection.

Q. What did he say? [353]

A. He kept on stating that he didn't know what I was talking about.

Q. Didn't he tell you he didn't know about any marijuana around there?

A. Well, he stated that—he says, “You're a Treasury Agent. You find out. You're the smart one.”

I asked him again, “Well, how about the transaction—the carrying the package?”

He says, “I don't know what you're talking about.”

Q. He says, “I don't know what you're talking about”?

A. That is correct.

Q. He kept saying that over and over again?

A. That is correct, sir.

Q. Did you then strike him?

A. No, sir.

Q. What did you hit him with?

A. My fist, sir.

Q. How many times did you hit him with your fist?

A. Oh, about two or three times.

Q. Did you hit him in his eye?

(Testimony of Michael Gullon.)

A. I don't recall sir. I hit him, the front of his body at some point.

Q. What did he say to you at that time?

A. He didn't say anything.

Q. You just hit him and he didn't say [354] anything?

A. No, sir; he didn't say anything.

Q. Did you hit him in his ear?

A. I don't recall, sir.

Q. Did you knock him out? Did you knock him to the floor?

A. He fell against the wall, sir.

Q. And did he fall to the floor?

A. No, sir.

Q. You searched him, didn't you?

A. I advised him to place all his credentials and all his possessions on the top of the table.

Q. Did you search him?

A. After all his personal property was on top of the table, I searched him for weapons.

Q. Did you find any? A. No, sir.

Q. Well, when he fell to the floor, did you kick him?

A. I didn't say he fell down, sir. I said he went against the wall and then he stood up again.

Q. He fell against the wall and then he stood up again?

A. Well, he just held himself against the wall.

Q. Did you kick him then?

A. No, sir; I didn't kick him.

Q. Didn't you kick him with your shoes on his

(Testimony of Michael Gullon.)

legs? A. No, sir; I did not. [355]

Q. Did you book him at the county jail?

A. No, sir; I did not.

Q. Do you know who booked him?

A. No, sir; I don't.

Q. Did you ever go over there to examine the booking certificate?

A. I don't have any reason to look at the certificate.

Q. Well, do you know, as a matter of fact, that they did not photograph this man at any time after he was booked? Do you know that?

A. First time I heard about it, sir.

Q. Did you leave any instructions with the Sheriff's office not to take any pictures of this man?

A. No, sir. I didn't book him. I never talked to the sheriffs about him.

Q. Did you give any instructions to any other officers or did you officers talk about directions to be given the sheriff not to take any pictures of him?

A. I'm not the agent in charge. I am only an agent. I don't give instructions up in the office.

Q. Did you talk it over with the other officers not to have any booking pictures taken of him, or at any other time? A. No, sir.

Q. Do you know who booked him there?

A. No, sir. [356]

Q. Do you know who went over to the county jail with him? A. No, sir.

Q. You say you searched him. You found no

(Testimony of Michael Gullon.)

weapons on him, he kept maintaining his innocence, and then you struck him; is that correct?

A. No, sir; that isn't correct.

Mr. Bender: The Government objects to this entire line of questioning on the ground that there is no evidence of a confession or admissions made by this defendant at the county jail or after he was booked, and this entire testimony is irrelevant—it has nothing to do with it.

Mr. Marcus: It is part of the *res gestae* and it goes to consciousness of guilt—it goes to denial at all times.

The Court: I have let it in. You have about covered everything with him, haven't you?

Mr. Marcus: That is right. That is all.

The Court: That's all.

Redirect Examination

By Mr. Bender:

Q. Mr. Gullon, relate just what happened in connection with this striking of the defendant. What occurred?

A. Well, after we—after I took him to the interrogation room, I took his handcuffs off and—

Q. Just a moment until Mr. Marcus is finished talking. [357] Continue.

A. Are you through, Mr. Marcus?

Q. Go ahead.

A. I'm sorry. After the handcuffs were taken away from him—I did that personally—I asked the

(Testimony of Michael Gullon.)

defendant to take all his personal property from his pockets, which he did, and place on top of the desk. I searched him for weapons. There was none.

I then asked the defendant to step next to the fingerprint equipment. We have to fingerprint the defendants. I took an FBI fingerprint card out to fingerprint him. I grabbed his left hand to fingerprint him. At that time the defendant pushed me against the wall and raising his right hand. Doing so, I fell backwards, and then I struck him and we had a scuffle and I subdued him and I then handcuffed him to the chair that is in the interrogation room.

Q. Did you ever kick the defendant?

A. No, sir; I didn't have no cause to do it.

Q. Now, directing your attention to the two automobiles that were on the parking lot over at the Beverly Ranch Market, you say you observed both cars parked in parallel position facing in a northerly direction and that you saw a defendant, this defendant Lozoya, carrying a bag from his car to the Government vehicle; is that correct?

A. That is correct, sir. [358]

Q. Just before you saw him carry the bag from the back portion of his car toward the Government vehicle, did you see the lid or the deck of the automobile in a raised position?

A. Yes, sir; that I could see; it was in a raised position.

Q. Did you at any time see the lid or deck of the Government car in a raised position?

(Testimony of Michael Gullon.)

A. Yes, sir; I could see part of it, a small section of it.

Q. You say you could or did see?

A. Yes, sir; I did see a small section of it.

Q. And this was at the time that the transfer was being effectuated? A. That is correct.

Q. At the time you testify you saw the defendant carry the material to the Government car?

A. That is correct, sir.

Q. Did the bag which you saw defendant carry to the Government car in general resemble the bag that I have in my hand? A. Yes, sir; it did.

Q. I am standing about the same distance from you that Mr. Marcus stood earlier today?

A. Yes, sir. [359]

Q. Would you inspect the bag, which is a portion of Government's Exhibit 1, and tell us if you have ever seen it before (handing the exhibit to the witness)? A. Yes, sir; this is the same bag.

Q. I observe some initials in the upper left-hand corner or the upper portion. Do you recognize any of those initials? A. Well, the initials of—

Q. M.I.G.—do you know whose those are?

A. Those are Agent Goodman's initials. At the time the initials were placed there, I observed Agent Goodman place his initials there.

Q. What is this R.E.N.—do you know what that is?

A. No, sir. My initials are blurred on here.

Q. You recognize Agent Goodman's, though?

A. Yes, sir; those are Goodman's.

(Testimony of Michael Gullon.)

Q. Whose initials are B.W.P., do you know, or is that a P? A. This is Freeman.

Q. Oh, B.W.F.? A. Freeman.

Q. Is he a Narcotics Agent?

A. Yes, sir; Freeman.

Robert E. Miller.

Q. R.E.M. indicates Robert E. Miller? [360]

A. My initials are blurred on here. My initials are small. I made them with a small pen. But those are the initials of the other agents.

Q. When were those initials placed on this Government's Exhibit 1, the burlap bag, do you recall?

A. I placed my initials there at the time the evidence was in the office of the Bureau of Narcotics.

Q. Did you also place your initials on any of the paper sacks which were contained?

A. Yes, sir; I did.

Q. Where were these paper sacks contained, or did you ever observe it? A. Inside the bag.

The Court: He already testified to that, didn't he?

Mr. Bender: I don't recall his identifying the initials, your Honor. I know Agent Goodman did.

The Court: I thought he testified from the exhibit.

Q. (By Mr. Bender): Would you inspect the bags or any of the bags? Inspect this one. That is one of the bags in Government's Exhibit 1.

A. Yes; here are the initials M.G.

Q. Do you recognize any of the other initials on any of the bags?

(Testimony of Michael Gullon.)

A. Meyer Goodman—Agent Goodman.

Q. Who else? Anyone? [361]

A. Agent Freeman, Agent Miller, Agent Ramirez. That is all I can recognize here.

Q. Are these the bags that were obtained from defendant Lozoya?

A. Yes, sir; they are the same identical bags.

Q. Mr. Gullon—

Mr. Bender: Your Honor, I didn't go into this on direct examination and I wonder if the court would object to going briefly into the duties of a Federal Narcotics Agent with respect to what they are to do with material obtained from the defendant in a narcotics case?

The Court: I don't think we need to do that. We have taken so much time in this case already. We have covered everything they did in this particular case. That is all the court is concerned with.

Mr. Bender: Yes, your Honor.

No further questions.

Recross-Examination

By Mr. Marcus:

Q. Just one question, sir. What is the name of the tall, blond officer who was in this courtroom or around this courtroom yesterday in connection with this case?

Mr. Bender: Did you say in this courtroom?

Mr. Marcus: He was in here and then he went out.

(Testimony of Michael Gullon.)

Mr. Bender: During the court in session? [362]

Mr. Marcus: I didn't say he was in here during court in session, but he was in the courtroom.

Q. What was his name?

A. You mean Agent Miller?

Q. I don't know his name. Is there a man by name of Agent Miller? A. Yes; there is.

Mr. Marcus: Permit me one moment, your Honor.

Q. Did he come into the room when you were beating this defendant?

Mr. Bender: The Government objects to this question on the ground that counsel is assuming something that is not in evidence when he says "beating this defendant."

Mr. Marcus: He testified himself that he struck him several times about the body.

The Court: Overruled. You may answer.

Q. (By Mr. Marcus): Did he come into the room at that time?

A. At the time that I fought with the defendant, nobody came into the room.

Q. Did Mr. Miller come in there?

A. A short time later one of the Agents came in, one or two of the Agents came in after the defendant——

Q. Was it Mr. Miller came in?

A. I don't recall, sir. [363]

Q. Didn't you say, "Miller, take over. Be sure and don't mark him up"? Do you remember saying that?

(Testimony of Michael Gullon.)

A. No, sir; I never did give such instructions or mention anything like that.

Q. Did you see Miller beat him, too?

(A pause.)

Q. Did you?

(No answer.)

Mr. Marcus: That's all. You may step down.

Mr. Bender: Just a moment. I submit there is a question asked.

Mr. Marcus: If he doesn't answer it, I am not going to press him. His silence is more obvious than the answer would be.

Mr. Bender: Give him an opportunity to answer, counsel.

Mr. Marcus: He doesn't take the opportunity.

The Witness: At no time did any Agent, in my presence, beat anybody up. I was the only one that fought with the defendant.

Q. (By Mr. Marcus): The defendant never struck you, did he?

A. Yes, sir; he struck me first and pushed me against the wall.

Q. You said he pushed you against the wall. As you were coming back from against the wall, you began striking [364] him?

A. Well, we exchanged blows.

Q. You didn't say that before, did you?

A. I said the defendant struck at me and I hit him back.

(Testimony of Michael Gullon.)

Q. By the way, he was wearing his glasses at the time, wasn't he? A. That is right, sir.

Q. And you knocked his glasses off, too, didn't you? A. No, sir, I did not.

Mr. Marcus: That's all.

The Court: That's all.

Mr. Bender: Your Honor, the Government has another witness.

The Court: Have this witness bring in the other witness.

Mr. Bender: Yes.

Mr. Gullon, would you ask——

(A pause.)

The Court: Is this the witness you want?

Mr. Bender: Yes, your Honor.

The Court: All right.

Mr. Bender: Mr. Freeman, will you take the stand—Bill Freeman.

Mr. Marcus: Counsel, is Agent Miller [365] available?

Mr. Bender: I believe he is out on assignment, but I think we can obtain him for you. Perhaps we can ask Mr. Freeman if Miller is available. I know he was in the office and indicated he had an assignment he preferred to go to, and I told him I didn't need him.

Mr. Marcus: Do you want to stipulate that his testimony will be substantially the same as the last witness?

Mr. Bender: Well, "substantially" is a big step,

counsel. I would rather put him on and have his testimony.

The Court: Well, let's make it brief. We are three days on a marijuana case.

Mr. Bender: I know. I have never taken this long on any narcotics case, conspiracy and all.

The Court: Take the stand.

BILL W. FREEMAN

called as a witness for the plaintiff, being first duly sworn, was examined and testified as follows:

The Clerk: State your full name, please.

The Witness: Bill W. Freeman.

The Court: All right, don't have him go over the same ground that you have covered. Ask him anything different.

Direct Examination

By Mr. Bender:

Q. Mr. Freeman, what is your profession or occupation?

Mr. Marcus: I will stipulate that he is an [366] agent.

Mr. Bender: That he is a Federal Narcotics Agent?

Mr. Marcus: Yes.

Q. (By Mr. Bender): For how long have you been so employed?

Mr. Marcus: I will stipulate to that. How long has he been employed?

Mr. Bender: Let him tell us.

(Testimony of Bill W. Freeman.)

The Witness: 21 months.

Q. (By Mr. Bender): Directing your attention to on or about May 17, 1956, at about 7:00 o'clock in the evening, in the vicinity of the Beverly Ranch Market at the intersection of Poplar and Beverly Streets in Montebello, California, were you present at that place at that particular approximate time?

A. Yes.

Q. With whom were you present?

A. I was standing with Agent Gullon near the Ranch Market.

Q. We have here a general rough descriptive drawing on the blackboard indicating north at the top, south at the bottom, east to the right, west to the left of this intersection. Would you approach the drawing and point out to the court approximately where the Beverly Ranch Market is located with reference to that drawing?

A. This is the market here on the corner. [367]

Q. Is there a sidewalk that parallels that market on Beverly Boulevard? A. Yes.

Q. Going in an easterly direction on Beverly Boulevard, show us where, approximately, on the sidewalk you were standing?

Mr. Marcus: Can you mark it with an X?

The Witness (Marking the diagram): Right at the corner of the market.

Mr. Marcus: Make it a little bit bigger, will you, please?

Q. (By Mr. Bender): Mr. Freeman, you didn't stand in one place, did you?

(Testimony of Bill W. Freeman.)

Mr. Marcus: Well, you asked him where he was standing, and he marked it "X."

Mr. Bender: That was approximately 7:00 o'clock in the evening.

Q. Did you stand in one place all of the time you were there? A. No, I didn't.

Q. What did you do?

A. Well, I moved^d to the front of the sidewalk next to the telephone pole, purchased a newspaper, walked back, and just generally walked right in that area.

Q. You were purportedly engaged in conversation [368] occasionally with Agent Gullon, weren't you? A. Yes.

Q. During the time you were on the sidewalk did you at all times look in any particular direction?

A. Well, while I was on the sidewalk I generally looked at Agent Gullon and when he would say—

Mr. Marcus: Just a moment. Never mind what he said.

Q. (By Mr. Bender): When he would say something to you?

A. When he would say something to me, I would look in the direction of Agent Ramirez or in the other direction—in other words, I was pretending to engage in conversation.

Q. On the sidewalk? A. On the sidewalk.

Q. For the purpose of distracting attention from you and the possibility that you might be ascertained to be a Narcotics Agent or officer?

A. Yes.

(Testimony of Bill W. Freeman.)

Q. While you were standing there did you observe where Agent Ramirez was? A. Yes.

Q. Where was Agent Ramirez?

Mr. Bender: Mark it with an X, please.

(The witness marks the diagram.)

Mr. Bender: It is a pretty small area there, counsel.

Mr. Marcus: Make a small X. [369]

The Court: Yes, make a small one.

Q. (By Mr. Bender): From now on we will refer to that X as Car No. 2.

Mr. Marcus: He hasn't said "car." He said Agent Ramirez.

Q. (By Mr. Bender): We will refer to it as the approximate vicinity of Agent Ramirez. Was Agent Ramirez in an automobile when you first saw him?

A. Yes.

Q. What type of automobile?

A. Black convertible Mercury, I believe, 1953.

Q. When you first observed Agent Ramirez, did you observe any other car parked parallel with the Government's car? A. No.

Q. Directing your attention to about 7:30 in the evening on May 17, 1956, what, if anything, did you observe at that time that concerns this case?

A. I observed coming east on Beverly Boulevard and stopped at a red light here, approximately, a 1940 Chevrolet—I believe it was a Chevrolet, a dirty color—a cream-colored dirty car, and driving it I observed that it was the defendant Lozoya.

(Testimony of Bill W. Freeman.)

Q. How did you recognize the defendant Lozoya at that time, if you did? Did you recognize [370] him?

A. I recognized him as fitting the description of defendant Lozoya, as shown me by Agent Ramirez. He had a photograph of the defendant.

Q. He had shown that to you before that evening or at least before the time you saw the car approaching the intersection? A. Yes.

Q. What happened to the automobile after it approached the intersection and stopped at the red light? Where did it go?

A. It turned right here, where I lost it from view. I next saw it parked directly in front of the vehicle Agent Ramirez was sitting in.

Q. In which direction was the automobile being driven by the defendant facing at the time you first saw it parked directly in front of Agent Ramirez' automobile? A. Facing east, I believe.

Q. Which direction was the Government's vehicle facing at this time, in general?

A. Facing north.

Q. What occurred at that time?

A. I observed that Agent Ramirez—I was not watching all of the time—when the car arrived there—I waited for it to arrive, and turned back, and then I engaged in conversation with Gullon, and then I turned back and observed [371] Agent Ramirez was sitting on, I believe, the driver's side of the defendant Lozoya's vehicle and appeared to engage in conversation with defendant Lozoya.

(Testimony of Bill W. Freeman.)

Mr. Marcus: Will you mark that X on the driver's side of Lozoya's automobile?

(The witness marks the diagram.)

Q. (By Mr. Bender): What occurred then?

A. I immediately turned back. I just turned around to see, myself.

Q. Turned around to face Gullon to avoid suspicion?
A. Yes.

Q. That was your thought, wasn't it?

A. Yes.

Q. Did you then later turn back and look in the direction of Agent Ramirez again?

A. Yes, I did, when——

Q. What did you observe when you looked back again?

A. I looked back and observed the defendant's vehicle was parked on the left side of Agent Ramirez' vehicle facing north.

Q. Will you estimate what distance separated these two vehicles—that is, the two sides?

A. About four or five feet, approximately.

Q. What did you observe happen then?

A. I observed defendant Lozoya was standing at the [372] rear of his vehicle with the trunk open.

Q. Did you actually see him open the trunk?

A. No, I didn't.

Q. Did you see the lid of the trunk as being up?

A. Yes.

Q. What happened then?

A. I turned around again, and in my own mind

(Testimony of Bill W. Freeman.)

I believe he was about to deliver the marijuana that we heard he was going to deliver.

Mr. Marcus: I move to strike that.

The Court: That may go out.

Q. (By Mr. Bender): What did you see?

The Court: Take the stand again. What did you see him do?

The Witness: I didn't see anything then, and I took part in the arrest.

Q. Where did you go then at this time?

A. I proceeded to the center of the market, to the rear of the market, because at that time I believed it was time to make the arrest.

Mr. Marcus: What was that last statement?

The Court: He believed that it was time to make the arrest.

Q. (By Mr. Bender): Then you didn't actually see the defendant carry any substance or burlap bag or anything in [373] his hands from one car to the other? A. No.

Mr. Marcus: He testified that he didn't see anything.

The Court: Yes, he said no.

Is that all?

Mr. Bender: No, your Honor.

Q. What did you do after you ran or traveled through the market?

A. I observed Agent Goodman approaching the defendant, and Agent Ramirez, so I immediately ran to where they were standing myself.

(Testimony of Bill W. Freeman.)

Q. Did you actually run through the market itself?

A. I moved quickly. I may have run about five feet or six feet or seven feet—I started to run, and then I decided I might have enough time to walk through without creating too much disturbance.

Q. What was your thought in going through the market?

Mr. Marcus: Counsel, please.

Mr. Bender: State of mind.

Mr. Marcus: What difference does it make—his state of mind?

The Court: I'll sustain the objection.

Mr. Bender: All right, your Honor.

Q. After you exited from the market, what did you do?

A. I ran over to where the defendant was standing with [374] Agent Ramirez and reached the area just a few seconds—I couldn't tell exactly how much longer—a few seconds after Agent Gullon had arrived there, and with Agent Gullon placed defendant Lozoya under arrest.

Q. Did you hear him place him under arrest?

A. Yes.

Q. What did he say, if you recall?

A. I can't remember the exact words. I believe it was, "You're under arrest. We are Federal Narcotics Agents." I believe that is what he said.

Q. Mr. Gullon said he was a Federal Narcotic Agent?

A. Yes.

Q. What happened then?

(Testimony of Bill W. Freeman.)

A. We then proceeded to question the defendant or ask him—I didn't question him myself. I stood there and kept the defendant under my observation, because I didn't know but what he might give an argument or something.

Q. Did you see Agent Goodman have the Government's Exhibit 1 in his hands at any time at the scene of the arrest? A. Yes.

Q. Relate what occurred with reference to that incident. What did you observe happened?

A. Agent Goodman asked the defendant—

Q. Defendant who? A. Lozoya. [375]

Q. Is that the gentleman seated at the counsel table here behind Attorney Marcus? A. Yes.

Q. What did he ask him?

A. He asked him what was in that sack.

He says, "What sack?"

"The sack I saw you take from your car and put in this fellow's here," indicating Agent Ramirez' car.

He says, "I don't know what you're talking about. What sack?"

Agent Goodman, during the conversation, was walking to the back of the automobile, opened the trunk and removed this large burlap sack or bag and stated it was "This god damn sack" is what he said.

Q. What did the defendant say to that, if anything?

A. He says, "I have never seen it before," or something like that. He wouldn't admit anything.

Mr. Bender: You may cross-examine.

(Testimony of Bill W. Freeman.)

Cross-Examination

By Mr. Marcus:

Q. Do you pronounce that Freeman, sir?

A. Yes.

Q. Mr. Freeman, were you with Officer Goodman when you started to run? A. Yes. [376]

Q. How far were you standing from him at that time? A. From Officer Gullon?

Q. Officer Gullon? A. About two feet.

Q. When you started to run, how far were you from him at that time? A. Oh—

Mr. Bender: I didn't hear the question.

Q. (By Mr. Marcus): How far were you from Officer Gullon when he, Officer Freeman, started to run toward the back? How far were you from him? You said a few feet, didn't you?

A. Approximately ten feet maybe.

Q. Ten feet?

A. Ten—I don't remember exactly.

Q. Well, were you talking to him about that time? A. Yes, I was talking to him.

Q. You were close enough to talk to one another, were you? A. Yes.

Q. Were you the same distance, approximately, as you and I are at this moment?

A. When we were talking?

Q. Yes.

A. No, I was closer than that. [377]

Q. How about this distance?

(Testimony of Bill W. Freeman.)

A. Varying between that and maybe closer.

Q. And you were talking to him at the time?

A. Yes.

Q. And then did you start to run toward the back?

A. I moved quickly. I didn't start to run until I entered the market.

Q. When you entered the market, how far were you from the door of the market at that time?

A. Well, the market is an open front, so from the entrance on this side was about, oh, five or six feet approximately or maybe less.

Q. Within five or six feet to the entrance of the market? A. Yes.

Q. That is, from the position that you were on the sidewalk you were five or six feet from the entrance of the market; is that correct?

A. Yes.

Q. And Officer Gullon was within two or three feet from you?

A. Approximately. I don't remember the exact measurements.

Q. So you went through the building at the time, didn't you? [378] A. Yes.

Q. Did Officer Gullon go through the building?

A. No, I didn't see him.

Q. Did he run along with you?

A. I don't know what he did.

Q. Well, if you were together and you started to run, how did you happen to start running at the time?

(Testimony of Bill W. Freeman.)

A. I saw the trunk was open. I said, "This must be the time," while I engaged in conversation with Gullon, and then I started to run.

A. Yes.

Q. You and he were talking to one another?

A. Yes.

Q. And you were engaged in conversation with him at the time? A. Yes.

Q. And you saw something lift up in the back of the car? A. Yes.

Q. You don't know whether it was a trunk or not, do you? A. Yes, I do; it was the trunk.

Q. It was the trunk of whose car?

A. Of the defendant's vehicle.

Q. Did you see anything else happen at that time?

A. I didn't look any longer. I just glanced real [379] quick and saw that.

Q. And that was at the time the trunk of the car was going up?

A. I noticed the trunk. I didn't notice any movement. I glanced real quick and then moved.

Q. You went through the building?

A. Yes.

Q. Did you see Officer Gullon go along with you?

A. No.

Q. Where did he go?

A. Do you want my opinion?

Q. Not your opinion. Where did you see him go?

A. I next saw him approaching the defendant.

Q. At least, you were closer to the front of the building, were you not, than you were to the wall?

(Testimony of Bill W. Freeman.)

A. What wall?

Q. The east wall of the building. You were closer to the front of this building than you were to this wall, weren't you?

A. No, I was closer to the wall.

Q. You were closer to the wall? Did you go around to go through the building, or were you directly in front of the building at the time?

A. I was standing right there at the corner where I could turn around and look at any [380] time.

Q. I didn't ask you that. My question was, weren't you in front of the building, so when you started to run you ran right through the building?

A. No, I was not in front of the building.

Q. How far were you from the actual front of the building?

A. By front do you mean front center?

Q. Any part of the front of the building. I haven't designated any particular portion of it. I mean the front of the building.

A. I was about two or three feet. Sometimes I was right up next to it.

Q. At the time you started to run you were right in front of the building, weren't you?

A. In front and one foot to the right, approximately.

Q. At least, when you turned around you went through the building, didn't you?

A. No, I went about three or four feet and then through the building.

(Testimony of Bill W. Freeman.)

Q. And you didn't pay any attention to Gullon at the time?

A. No, I was going to get into position.

Q. You didn't pay any attention to Gullon at the time? A. At what time?

Q. At the time you started to run? [381]

A. No, I didn't. I had to look where I was going.

Q. Didn't you see him at all as he started to run? A. No.

Q. When you went through the building, of course, you couldn't see anything back there, could you?

A. That is right, except the insides of the building.

Q. Did Gullon start going when you started going whatever way he went?

A. I don't know.

Q. When you got back there to the car Gullon was already there, wasn't he?

A. I stopped at the rear of the building to look again.

Q. Where did you look when you got to the rear of the building?

A. At the defendant and his vehicle.

Q. Did you see anything at that time?

A. At that time when I stopped I observed Agent Gullon approaching rapidly.

Q. How far was Agent Gullon from you at that time? A. Oh, approximately 15 feet.

Q. And how far was he away from you at that time? A. From me?

(Testimony of Bill W. Freeman.)

Q. Yes—Officer Gullon.

A. That is what I thought you asked the first place. [382]

Q. No. How far was he away from you?

A. About an equal distance almost, maybe a little further.

Q. 15 feet from you and 15 feet from the defendant, and you were stopped there? A. Yes.

Q. Did you see the defendant do anything at that time?

A. The defendant had his back to me.

Q. Did you see him do anything at that time?

A. He appeared to be engaged in conversation.

Q. How long did it take you from the time you started running through the building until the time you saw the defendant when you came out of the building—how long did that take? Was that just a matter of one or two seconds?

A. No, a matter of a minute, approximately.

Q. Took you a minute to go through the building?

A. No, because I stopped at the end and watched, and then I observed Agent Gullon approach and then I moved.

Q. From the time you started to run until the time you came to a stop and watched, how long did that take you?

A. Couldn't have been a full minute. Maybe 30 seconds, 45 seconds, something like that.

Q. You say you saw Officer Gullon. Where was he at that time when you came to a stop?

(Testimony of Bill W. Freeman.)

A. When I came to a stop, I saw him approaching the [383] defendants.

Q. Where was he approaching from?

A. From the north.

Q. Well, he was on the back of this parking lot at that time, wasn't he?

A. On the back of the parking lot?

Q. Yes, he was in the back of the parking lot—that is, the parking lot that is to the rear of the market?

A. To the rear and to the right of the market. That is where I saw him.

Q. Well, was it to the right of you?

A. To my left.

Q. To your left? And was he running at the time? A. Yes.

Q. Did you see Officer Ramirez do anything at the time you started to take off?

A. He appeared to be engaged in conversation with the defendant.

Q. Anything else?

A. No, I didn't observe anything else.

Q. Was he doing anything at the time except talking? A. I don't remember.

Q. Did he have anything in his hands at the time? A. I do not recall, sir.

Q. Didn't he have a package in his hand at that time? [384]

A. I do not recall seeing anything like that.

Q. Did you boys talk over what you were going

(Testimony of Bill W. Freeman.)

to do or what plans you had with respect to this matter before you went out there that evening?

A. Yes.

Q. At that time did you see Ramirez, or at any time did you see Ramirez in his automobile?

A. At which time did I see him?

Q. At any time did you see him sitting in the automobile?

A. You will have to make your question more clear. I don't understand.

Q. Did you see him sitting in his automobile at any time at the rear of that market?

A. Where I placed him, yes, right there where I put the X.

Q. Was he doing anything while he was in the automobile?

A. Eating a banana, I believe.

Q. You saw him eating a banana?

A. I saw him with a banana in his hand, because we were there quite a long time before.

Q. How many bananas did he eat that you remember?

A. I don't remember.

Q. This banana business didn't have any significance, [385] did it?

A. Yes, the prearranged signal was when the peddler delivered the marijuana he would throw the banana peel down when he saw it was marijuana.

Q. This package, to your knowledge, was never opened out there, was it?

A. I don't know.

Q. Did you ever see it opened?

A. I was not observing that.

(Testimony of Bill W. Freeman.)

Q. Did you ever see the package at all?

A. I saw it after the arrest.

Q. You didn't see it at any time before?

A. No.

Q. You didn't see anybody transfer anything from one car to another, did you?

A. I was not looking that direction.

Q. I didn't ask you whether you were looking that direction. You said you were looking, you said you saw Ramirez eating bananas, you say you saw him seated in the car, you say you saw the defendant arrive, you say you saw him park his car. You mean to tell us now you weren't looking in that direction? Is that what you mean to say?

A. Will you repeat the question?

Q. Weren't you looking in that direction?

Mr. Bender: The Government objects to the question on [386] ground that there has been no time established.

The Court: Well, he can answer the question. I think you have about covered everything.

Mr. Bender: When, your Honor?

Mr. Marcus: Oh, that's all on that. I withdraw the question.

Q. Did you say you saw the defendant as he was approaching Poplar Street in an automobile?

A. Yes.

Q. How far up the street was he that you saw him in an automobile approaching?

A. Oh, approximately a hundred feet.

Q. A hundred feet? Do you know what the width

(Testimony of Bill W. Freeman.)

of this market is? You say you have yourself right in here now at that X. That is where you were all the time, weren't you, between here and the telephone pole? A. Yes.

Q. Do you know what the frontage of that market is? A. No.

Q. You have some idea. You were there for quite a long time, weren't you? A. Yes.

Q. What is the width of that market?

A. 40 feet, approximately.

Q. The frontage of the market is 40 feet? [387]

The Court: You asked him the frontage and then changed it to the width.

Mr. Marcus: Oh.

Q. The frontage of the market on Beverly?

A. It could be 50 feet, approximately.

Q. It could be 50 feet? A. Yes.

Q. If I told you that that market was 124 feet wide, would that refresh your memory a little bit?

A. I believe you have the wrong measurement, sir.

Q. Would that refresh your memory that the market was 124-foot frontage on Beverly Boulevard?

A. Does that include the parking lot, too?

Q. No, that doesn't include the parking lot. The parking lot and the market is 100 and——

A. It didn't impress me as being 124 feet.

Q. What is the width on Poplar Street?

A. About 36 feet, I would say.

Q. And you saw him up in the next block?

(Testimony of Bill W. Freeman.)

A. No; I saw him at Poplar and Beverly.

Q. As he approached the intersection?

A. I saw the car approach the intersection.

Q. And he was inside the car? A. Yes.

Q. So you were at least a couple of hundred feet from [388] a moving automobile, weren't you?

A. No; it didn't look like 200 feet to me.

Q. The car made a turn at Beverly and Poplar, didn't it? A. Yes.

Q. And he could have only been under your vision for a matter of a second inside an automobile?

A. No; he was parked at the red light—I don't know how long it was, and when he made a right turn he had to pause and I got a good look at his face.

Q. So you were able to identify a man in an automobile from the position you were standing at the end of that market to where the automobile was approaching at Beverly Boulevard on the intersection of Poplar; is that what I understand?

A. Resembling the description given to me.

Mr. Bender: Just a moment. The Government objects to the question on the ground that it is asking for a conclusion—you were able to identify.

Q. (By Mr. Marcus): You did identify the features of this man?

A. I saw enough to convince me it was the same automobile I saw arrive in front of Agent Ramirez' car in a few seconds.

Q. That isn't what I asked you. I am talking

(Testimony of Bill W. Freeman.)

about the person seated in the car, the features of the man. You [389] testified that you recognized the man approaching in the automobile?

A. Yes; I did.

Q. And I am to understand that you recognized the features as he was approaching the intersection of Poplar and Beverly?

A. No; as he was parked at Poplar and Beverly and making a right turn is when I recognized his features completely. I recognized the automobile approaching.

Q. Did you recognize the features of anyone else in that car? A. No; I did not.

Q. Did you see anyone else in the car?

A. Yes; there was somebody else.

Q. You couldn't recognize the features of that other person?

A. I was not looking at the other person. I knew the person driving the automobile would be the person I was interested in.

Q. You looked at the front of the car, you testified it was a yellow car—you said it was a dirty yellow, and you mean to tell us you didn't see the features of anybody else in the car?

A. I was not looking at anybody else in the car.

Q. When you are looking that distance you would have [390] to see two people, wouldn't you?

A. Yes.

Q. Did you see two people? A. Yes.

Q. Who was the other person?

A. A person known to me as Johnny.

(Testimony of Bill W. Freeman.)

Q. How long had you known him before that time?

A. I have seen him on one or two occasions.

Q. Before that occasion? A. Yes.

Q. Where did you see him?

A. On the first occasion I saw him make a delivery of marijuana to Agent Ramirez.

Q. When did he make a delivery of marijuana to Agent Ramirez—how long before this occasion?

A. Several months.

Q. How long? A. I don't know exactly.

Q. Where?

A. Intersection of—I can't remember now.

Q. Was this an employee of the Department, this Johnny you speak about?

A. He is a special employee.

Q. A special employee? And he was delivering marijuana to Ramirez? [391]

A. That was before he was a special employee.

Q. Before he was a special employee he was delivering marijuana? A. Yes.

Q. To Ramirez; is that right? A. Yes.

Q. What was done with that marijuana that Johnny delivered to Ramirez? What did you do with it?

A. It was retained as evidence for use in the prosecution of Johnny.

Q. Oh, you prosecuted Johnny?

A. That is right.

Q. And you retained that marijuana, did you?

A. Yes.

(Testimony of Bill W. Freeman.)

Q. And then you got him to be a special employee?

A. We don't like to use the term "informer," because we believe that anybody who works for us——

Q. I don't care what you call him. You said he was an employee?

A. That is a term used, "special employee."

Q. And this special employee was working with you? A. Not with me.

Q. With Officer Ramirez? A. Yes.

Q. Did Officer Ramirez give him marijuana to use on [392] occasion, too? A. No.

Q. Did he tell him to get marijuana to use on occasion? A. No.

Q. You say he delivered marijuana to Ramirez. Did Ramirez give him the marijuana to deliver?

A. Will you repeat the question?

Q. You say Johnny delivered marijuana to Ramirez. You say you saw that, didn't you?

A. Yes.

Q. And this was before this occasion involving Mr. Lozoya; is that right?

A. It has been several months before. It was before I even knew Johnny.

Q. I don't care how long it was. You actually saw that? A. I saw him deliver a package.

Q. How big a package was it?

A. (Indicating.) About five inches tall, three inches wide, two inches deep.

Q. You saw marijuana in that package, too?

(Testimony of Bill W. Freeman.)

A. I saw the package later and identified 140 marijuana cigarettes in it, yes.

Q. But it was marijuana? A. Yes. [393]

Q. Then you saw this same Villas in the automobile with Lozoya? A. Yes.

Q. You saw him as he parked there at the corner for the red signal? A. Yes.

Q. Why didn't you tell us that before, that you didn't recognize the——

A. I was not trying to recognize him. I already knew him. I was looking for the man behind the wheel.

Q. But I asked you the question directly if you recognized the party, and you said you couldn't.

A. I didn't understand the question.

Q. You didn't answer the question.

Mr. Bender: The Government objects on the ground that counsel is arguing with the witness, your Honor.

The Court: It is argumentative. You are about finished with him, aren't you?

Mr. Marcus: Yes; I am, your Honor.

Q. Did you come down to the station afterward?

A. Will you repeat the question?

Q. Did you come down to the Federal Building afterward? A. Yes.

Q. Were you here when Gullon was in there interrogating this boy? [394]

A. Was I in the—I was in the office of the Bureau of Narcotics in this building, yes.

Q. You know where the interrogation room is?

(Testimony of Bill W. Freeman.)

A. Yes.

Q. Were you in the next office?

A. Part of the time, yes.

Q. Did you see Officer Gullon go in there, too?

A. I don't recall whether he went in there or not.

Q. Did you hear any names being called the defendant? A. No.

Q. You heard Officer Goodman using bad language or foul and abusive language out there, didn't you?

Mr. Bender: Just a moment. The Government objects to the question on the ground that it is asking for a conclusion of the witness.

Mr. Marcus: Withdraw the question.

Q. Did you hear Officer Gullon cussing the defendant?

Mr. Bender: Same objection, your Honor.

The Court: Overruled.

Mr. Bender: Cussing is a conclusion.

The Court: Well, he can tell us. It will shorten it. Do you remember any such conversation?

The Witness: No; I do not.

Q. (By Mr. Marcus): Did Officer Goodman say anything to you at the time about striking the defendant? [395] A. No.

Q. He didn't mention it to anybody, did he?

A. At what time?

Mr. Bender: The Government objects on the ground that there is no foundation laid as to time.

The Court: I'll overrule it at this particular time.

(Testimony of Bill W. Freeman.)

Q. (By Mr. Marcus): Did Officer Gullon say anything to you in the Federal Building at any time about striking the defendant?

A. Yes; after he did; yes.

Q. Did he tell you he had struck him about the head?

A. I don't remember where he said. He told me he had to strike him.

Q. This defendant all of the time had his glasses on, didn't he? A. No.

Q. Who took his glasses off?

A. I don't remember.

Q. You saw him without his glasses?

A. In the Federal Building, yes.

Q. Did you book him at the county jail?

A. I was there, yes.

Q. Did you instruct the officers over there not to take any pictures of him? A. No. [396]

Q. Do you know that no pictures were taken of this man at any time?

A. Pictures were taken, because I saw them the next day or day after that.

Q. You saw the pictures taken of this fellow at the county jail at the time he was booked?

A. At least I believe they were pictures——

Q. Do you know that he has never had his picture taken in the course of booking up to the present time?

A. I requested photographs of him.

Q. Did you get any photographs?

A. Agent Ramirez, I believe, picked them up.

(Testimony of Bill W. Freeman.)

Q. I am not asking you whether Ramirez picked them up. I am asking you if you picked up any pictures? A. I never picked them up.

Q. You didn't either, did you? Did you see his eyes blacked when you took him there to book him?

A. No.

Q. Did he complain about not being able to hear through one ear?

A. No; he heard me very well when I——

Q. You booked him, did you?

A. I probably——

Mr. Marcus: Do you have the booking slip here?

Mr. Bender: May the record show that the witness has [397] not been allowed to answer the last question?

The Court: Well, the witness stated that he booked him over there.

Q. (By Mr. Marcus): Do you notice on this booking slip here that he claims a black eye?

A. No.

Q. You didn't see that? A. No.

Q. Read it. You booked him. Did you see the bruises on the right leg, on that booking slip?

A. No; I didn't.

Q. Is your name on this booking slip? Who is this by? A. My name isn't there.

Mr. Bender: By "this" you are pointing to the lower left-hand corner?

Mr. Marcus: Yes, "booked by."

Q. Did you sign your name to his booking slip?

A. I don't remember whether I did or not.

(Testimony of Bill W. Freeman.)

Q. Well, did you examine the booking slip after you booked the man?

A. This is a property slip. I never saw his property slip then.

Q. It says: "Recent injury or illness: Claims black eye, bruises on the right leg." Did you see that when that was filled out? [398]

A. That was not filled out in my presence. We fill out a form a little bit different than that.

Q. Did you see any bruises on his right leg?

A. No.

Q. Did you see any black eye? A. No, sir.

Q. He made no complaint to you at all?

A. No.

Mr. Bender: Just a moment. The Government objects to this whole line of questioning.

Mr. Marcus: I am through.

Mr. Bender: On the grounds that it has nothing to do with the case whatever.

The Court: He said he has finished.

Is that all?

Mr. Marcus: That is all.

The Court: Is that all?

Mr. Bender: No.

The Court: Mr. Bowler wanted to see me at 3:00 o'clock.

(Testimony of Bill W. Freeman.)

Redirect Examination

By Mr. Bender:

Q. Mr. Freeman, in what general vicinity did you see Johnny Villas make the delivery of marijuana to Agent Ramirez?

Mr. Marcus: Just a moment. [399]

Mr. Bender: You went into that on cross-examination, counsel.

Mr. Marcus: Please, I didn't say he made any delivery of marijuana of any kind. This officer doesn't know whether it was marijuana or sticks of wood in that sack.

It is objected on the ground that it assumes a fact not in evidence.

Mr. Bender: This witness has testified that Villas delivered marijuana.

The Court: I'll let him testify. Overruled. Go ahead.

The Witness: I was trying to think of the town or area, but it is east of Montebello, quite a ways east of Montebello.

Q. (By Mr. Bender): Did you in this case on May 17 or May 18, 1956, look into any of the paper bags which are marked in evidence as Government's Exhibit 1? A. Yes.

Mr. Marcus: That is objected to as being improper redirect examination, your Honor.

The Court: That is true, but I will let him answer it.

(Testimony of Bill W. Freeman.)

Mr. Bender: I think it is true.

I had a couple of points I forgot on direct examination.

The Court: I said I'll let you go ahead.

Mr. Bender: Thank you.

The Witness: Yes, I did look into the bags.

Q. (By Mr. Bender): Did you examine the contents of [400] any of the packages in the paper bags? A. Yes.

Q. Have you on prior occasions seen marijuana?

A. Yes.

Mr. Marcus: This would simply be corroborative now of the other officers' testimony.

Mr. Bender: That is true.

Mr. Marcus: We could stipulate with respect to his testimony that it would be substantially the same on direct examination and cross-examination as the previous witness.

Mr. Bender: If you will stipulate, counsel, that in this Agent's opinion the substance found in Government's Exhibit 1 appears to resemble marijuana. That is what I am getting at.

Mr. Marcus: Not in Exhibit 1; the substance that he saw at the time. How does he know? He hasn't even looked at this yet.

Q. (By Mr. Bender): Did the substance which you observed in the paper bags which were obtained in connection with this transaction from defendant Lozoya appear to resemble any substance with which you are familiar? A. Yes, sir.

Q. What substance? A. Marijuana.

(Testimony of Bill W. Freeman.)

Q. Did you inspect the contents of one of the paper [401] bags? It appears to have some initials on it. Do you see your initials there?

A. Yes; BWF right here.

Q. When did you place them there?

A. May 17th.

Q. Did you inspect the contents of the bag? What does the contents appear to resemble?

A. Marijuana.

Mr. Bender: I have about two other questions which are actually not redirect examination, your Honor.

The Court: Go ahead.

Mr. Bender: More properly direct examination.

Q. Mr. Freeman, you don't wear glasses, do you?

A. Yes, I do, occasionally.

Q. Would you put them on?

A. (Witness puts on his glasses.)

Q. Did you have those glasses on, on May 17th?

A. Yes, I did.

Q. What was the condition of your eyes with reference to the ability to see at a distance of approximately a hundred feet without your glasses?

A. Without my glasses it would be hard for me to distinguish features of a face, although I could distinguish profile and manner of walk.

Q. Did you have your glasses on at all during the [402] time you testified to here concerning this transaction? A. Yes, I did.

Q. What then is your general ability to distinguish objects at approximately a hundred or fewer feet with your glasses on?

(Testimony of Bill W. Freeman.)

A. Very good. I have 20-20, up to 20-15 vision with my glasses on.

Q. With reference to Agent Joe Ramirez, does he wear glasses?

A. No, not to my knowledge does he wear glasses.

Q. Similarly, the same question with reference to Agent Goodman; does he wear glasses?

A. Not to my knowledge.

Q. And Agent Gullon? A. No.

Q. So far as you know, they have no impediment of their ability to see? A. That is right.

The Court: As far as he knows. That is sufficient. Haven't you covered everything?

Mr. Bender: No further questions.

Recross-Examination

By Mr. Marcus:

Q. You didn't see any package or sack or parcels taken from one car to another, did you? [403]

A. No.

Q. You don't know whether or not there was anything transferred from one car to another, did you?

A. Yes, I do know.

Q. Did you see it transferred? A. No.

Q. How do you know if you didn't see it?

A. Agent Ramirez told me so.

Q. Not what Agent Ramirez told you. I'm talking about your own personal knowledge of what you saw.

A. I didn't see it. I told you that before.

Mr. Marcus: That's all.

The Court: That's all.

(Testimony of Bill W. Freeman.)

Government's case?

Mr. Bender: Yes, your Honor, but before resting I would like a moment to review to make certain I haven't overlooked anything.

The Court: We will take the afternoon recess.

(Recess.)

The Court: Does the Government rest?

Mr. Bender: Yes, your Honor.

Mr. Marcus: Take the stand, Mr. Lozoya.

REFUGIO GONZALES LOZOYA

being the defendant herein, called as a witness on his own behalf, being first duly sworn, was examined and testified as [404] follows:

The Clerk: State your full name, please.

The Witness: Refugio Gonzales Lozoya.

Direct Examination

By Mr. Marcus:

Q. State your age. A. 36 years old.

Q. Where do you live?

A. County, East Los Angeles, on 4320 Griffin Street.

Q. Are you married or single? A. Married.

Q. Your wife's name?

A. Juanita Lozoya.

Q. On May 17th, were you living with your wife?

A. I was.

Q. And family? A. I was.

Q. Where?

(Testimony of Refugio Gonzales Lozoya.)

A. 4320 Griffin Street, in East Los Angeles.

Q. Were you engaged in any business on that date?
A. No, I was not.

Q. Were you employed at that time?

A. I was.

Q. Did you have any interest in any business at that time? [405]

A. I had to go and remove some equipment from my restaurant, because it was going to be taken over the following day.

Q. Did you have a restaurant prior to that time?

A. Yes, I did.

Q. What did you do with reference to that restaurant?

A. What did I do with reference to——

Q. Was the restaurant closed?

A. It was closed.

Q. Was it for sale? A. It was, sir.

Q. Do you know Johnny Villas?

A. Yes, I do.

Q. How long have you known him?

A. Well, I met him in 1951.

Q. Where did you meet him?

A. In the foundry. We worked together for about four or five months in El Monte.

Q. Did you see him in the early part of May, last year?
A. Last year?

Q. I mean this year, 1956?

A. In the early part of May?

Q. In May sometime did you see him?

A. Yes, I did.

Q. Did you have a conversation with him? [406]

(Testimony of Refugio Gonzales Lozoya.)

A. Yes, I did.

Q. Did you have a conversation with him with reference to a restaurant? A. Yes, I did.

Q. Tell the court what you talked to him about?

A. Well, he came to my restaurant and——

Mr. Bender: Just a moment. The Government objects to the question on the ground that it is asking for hearsay conversation between this defendant and someone who is not before the court; for that reason, being hearsay, it is not admissible.

Mr. Marcus: He is a government employee. He was acting under instructions.

The Court: I will overrule the objection.

Mr. Bender: He was a special employee. There is no evidence that he was at any time employed as an agent.

The Court: I'll overrule it.

Mr. Marcus: Go ahead and give the conversation.

Mr. Bender: Further, there is no indication that he was ever a representative of the Government.

The Court: I'll overrule the objection.

Q. (By Mr. Marcus): What was said? ~

A. Well, he came over to my restaurant and we were talking there. He boiled me a cup of coffee and we talked about our previous work in the foundry and things like that. [407-408] He also said he was working for a trucking outfit.

Q. Just give me the conversation as to the restaurant.

A. So I told him if he knew of anyone that was interested in buying a restaurant, that I had mine

(Testimony of Refugio Gonzales Lozoya.)

for sale. So he said no, he didn't at that time, but that he would try and if he know anyone he would let me know.

Q. Did you hear from him after that?

A. Well, on the 7th——

Q. Yes or no. A. Yes.

Q. How did you hear from him?

A. Through the phone.

Q. He called you or you called him?

A. He called me.

Q. What did he say to you?

A. He said he had someone interested on that restaurant that he wanted to buy it.

Q. Anything else said about a meeting or anything?

A. Yes. He also told me that this person was with him and that he would like for me to go over so I could meet him.

Q. Did he tell you you would meet him at any particular place?

A. Yes. He told me he would meet me on Garfield and Beverly Boulevard. [409]

Q. Did he set a time for you to meet?

A. Well, yes; it was about 7:00 o'clock in the evening.

Q. Did you meet Villas at Garfield and Beverly Boulevard? A. Yes, sir.

Q. About 7:00 o'clock, was it?

A. About 7:00 o'clock.

Q. On May 17th? A. On May 17th.

Q. Did you talk to him? A. Yes, I did.

(Testimony of Refugio Gonzales Lozoya.)

Q. What did he say to you?

A. Well, he got off his car, and then I asked him, "Where is the party that is interested on the place?" So he says, "Well, he is waiting further down." I says——

Q. He is waiting for you where?

A. He is waiting for me on the market.

Q. He was at a market?

A. It was a market, yes.

Mr. Bender: May the Government have the same running objection to all this conversation, your Honor?

The Court: Yes.

Q. (By Mr. Marcus): Then did you proceed to the market?

A. Yes. Well, he told me that he would go with me. [410] So we drove down to the market that the fellow was out there waiting.

Q. Did you go to the market?

A. Yes, we did.

Q. Did he direct you where to go?

A. Yes, he did.

Q. What did he say to you? How did it go?

A. Well, we went down there, but while we were driving we kept on talking just, you know, he told me how come I wanted to sell, that if I didn't make any good on the restaurant.

So I said, "No," I said, "My wife is sick. She is not feeling too well, and I am working."

Q. Where were you working at the time?

A. I was working for Trade Paper Company.

(Testimony of Refugio Gonzales Lozoya.)

Q. What kind of work were you doing?

A. It is warehouse. I was combination, their truck driver and warehouseman.

Q. How long had you worked for that company before May 17th? A. Three weeks.

Q. And before that time what did you do?

A. I was working at the restaurant with my wife.

Q. Well, you drove into the market, on the lot there, did you? [411] A. Yes, I did.

Q. Did you see anybody there?

A. Well, there was a lot of people around there.

Q. About what time did you arrive there, Mr. Lozoya, at the market?

A. Well, it must have been about 7:30.

Mr. Bender: Just a moment. The Government moves to strike the answer of the defendant saying that there were a lot of people around there, as being a conclusion.

The Court: All right.

Q. (By Mr. Marcus): I'll ask him the question: Were there any people there at the market?

A. Yes, there were.

Q. Was the market open? A. Yes.

Q. Was the parking lot open? A. Yes.

Q. Were there cars there?

A. Yes, there were.

Q. How many?

A. Well, there was quite a few. I didn't actually count them, but there was more than half a dozen.

Mr. Bender: Same objection, your Honor, to the "quite a few."

(Testimony of Refugio Gonzales Lozoya.)

The Court: Well, he said more than half a dozen. [412]

Q. (By Mr. Marcus): Did you see anybody or meet anybody there on the lot? A. Yes, I did

Q. Whom did you see there?

A. Well, I see this party that I was supposed to meet Johnny Villas had told me.

Mr. Bender: The Government objects to the testimony and moves that it be stricken on the ground that it is not responsive to the question; that part "I was supposed to see" is not an answer.

The Court: Well, the man that Johnny was to introduce him to. I will let that remain.

Q. (By Mr. Marcus): You drove onto the lot, did you? A. Yes.

Q. Did you meet the man as you drove on, when you drove on the lot and came to a stop?

A. I met the man.

Q. And then what did you do?

A. I got off my car.

Q. Was your car parked on the open lot there at the time? A. Yes, it was.

Q. Then what did you do with your car?

A. I backed it in.

Q. Where? [413]

A. Right parallel to this Mr. Ramirez's car.

Q. Were you introduced to him as Mr. Ramirez?

A. Yes, I was.

Q. Then did you get out of your car?

A. Yes, I did.

(Testimony of Refugio Gonzales Lozoya.)

Q. And then what happened? Just turn around and tell the Judge the story.

A. Well, I got off and I was introduced to him by Johnny Villas, and he told me his name was Mr. Ramirez, and then I told him, I said, "Are you still interested in buying my restaurant?"

He says, "I never heard anything about a restaurant." He says, "What I want to buy is marijuana."

I told him, I says, "What gives you the idea that I am selling marijuana?"

He says, "Well, if you haven't got any," he says, "I got quite a bit of money to get me some."

I said, "Certainly not. I can't get you any."

So then at that time, well, he started—I was going to start walking off, you know, but he reached with his right hand into his left upper pocket on his shirt and drew out some money. He says, "Look, I have enough money here to buy it."

I said, "I'm not interested."

At that time some more officers arrived and just with [414] drawn guns and then he says, "Where is the stuff?"

I said, "I don't know what you're talking about."

Q. Who said, "Where is the stuff"?

A. I believe it was Mr.—what's his name—I don't know the officer's name, I mean, you know.

Q. Was he on the stand? A. Yes, he was.

Q. Was it Gullon? A. Gullon.

Q. Or Goodman or Freeman?

A. No, it was——

(Testimony of Refugio Gonzales Lozoya.)

The Court: Well, one of them. It doesn't make any difference.

Q. (By Mr. Marcus): One of the officers?

A. Yes. He told me, "Where is the stuff?"

I said, "What stuff?"

He says, "You know what I'm talking about."

I said, "No, I don't. I actually don't know what you're talking about."

So right away they went through my car and started searching my car—one of the officers got in the car and started searching my car in the front seat, pulled the keys out of my car and went to the back and opened my trunk, and then they came back. [415]

Q. Did you give anybody any key?

A. No, I did not.

Q. Did you have any keys in your hands at all?

A. No, I did not.

Q. Did you take any sack, this sack here in particular, or any of the objects here and put it in the other car?

A. No, I did not.

Q. Then what happened?

A. Well, then, after they got through searching my car, they came to me and one of the officers, I believe, they asked Mr. Ramirez where was his car. So he says, "That car parked right there." So he said, "Give me the keys," he says. So he hands this officer the keys and went out to the trunk and opened his trunk and pulled out a gunny sack and they brought it before me, and Officer—I can't place the names—anyway, he pulled the sack out, pulled a bag out and

(Testimony of Refugio Gonzales Lozoya.)

showed me the bag and says, "Where did you get these stuff?"

I says, "I don't know what you're talking about." I said, "Why don't you ask the man who was driving the car you pulled it out from?"

So then they asked him.

Q. What did they ask him?

A. They asked, "Where did you get this stuff?"

And he says, "I don't know. I just borrowed the car from my girl friend." He said, "Why don't you go get her?" He says, [416] "I don't know what was in that car."

So then they came back to me he says, "All right, you * * *"—called me dirty names there.

Q. What did he say?

A. He says, "All right, you son of a bitch * * *"

Mr. Bender: I move to strike "dirty names."

The Court: What did they say?

The Witness: He said, "All right, you dirty son of a bitch, where did you get it?"

I said, "I'm telling you, I don't know where it came from." I said, "Why don't you ask the man," again I repeated myself.

So he says, "All right, let's go." So then at that time they handcuffed me and handcuffed Johnny Villas and got this Mr. Ramirez and they came back to him toward his car, and then they put me and Johnny Villas in one car and they also put the gunny sack that they had in the trunk of that car, and then they drove us in to the Federal Building.

Q. (By Mr. Marcus): Did anybody at any time

(Testimony of Refugio Gonzales Lozoya.)

out there open that sack and look at the contents of it?

Mr. Bender: Excuse me. The Government objects to that question on the ground that it is asking for a conclusion of this witness as to anybody at anytime having done this. This witness can only testify to what he saw, not what someone may have done out of his presence or when his back was turned.

The Court: Overruled. Go ahead. [417]

The Witness: What was the question?

Q. (By Mr. Marcus): Did anybody open that bag?

A. Well, they opened the sack, yes, and they pulled out a bag and they looked at it and he said, "Yes, yes," he says, "its marijuana," so they——

Q. And did Mr. Ramirez open the bag?

A. Well, I don't believe so. It was the other officer, Goodman—Goodman, yes.

Q. Did you ever tell Mr. Ramirez that you had "good stuff"? A. I never did.

Q. And tell him that it was sixty dollars a pound? A. No, I didn't.

Q. Or fifty-seven dollars a pound?

A. No, sir.

Q. Did you ever tell him anything——

A. I never mentioned anything of the sort.

Q. After that you were taken to the station?

A. That is right.

Q. That is down here in the Federal Building?

A. That is right, sir.

(Testimony of Refugio Gonzales Lozoya.)

Q. Were you taken up to the interrogation room? A. Yes, I was.

Q. Tell the judge what happened up there.

A. Well, they put me in the interrogation room and this [418] officer here now present sat me down in a chair.

Q. Referring to Mr. Gullon?

A. That is right, and without any conversation he started slapping me around right away.

Mr. Bender: Just a monent. Mr. Gullon walked in. I don't know yet whether I'm going to use him on rebuttal.

Mr. Marcus: I will not make any issue of it. Go ahead.

The Witness: He started slapping me around already and started calling me "You son of a bitch" and this and that, and he said, "Better tell me where you got it from."

I said, "I don't know anything about it."

He said, "If you don't tell me where you got it from, I'm going to slap the hell out of you." In fact, he said he was going to kill me. He threatened me my life and everything.

Q. (By Mr. Marcus): What did he say?

Mr. Bender: The Government objects—

The Court: He is going to relate the conversation.

The Witness: He said—well, he was slapping me, and then he said that if I didn't tell him that he was going to kill me.

(Testimony of Refugio Gonzales Lozoya.)

Q. (By Mr. Marcus): Those were his words?

A. Those were his words, yes, sir.

Q. Were you ever knocked down?

A. Yes, I was. [419]

Q. How many officers struck you there?

A. Two.

Q. Who were they?

A. Well, Officer—this officer present here.

Q. Officer Gullon?

A. Yes, Officer Gullon—he is the first one that struck me, and when he got tired then he walked out and they made a phone call.

Mr. Bender: The Government moves to strike the statement of the witness “when he got tired.”

The Court: Yes, that may go out.

The Witness: Then this Officer Miller came in, we’ll say about 15 minutes later, and he also, without asking me any questions, just walked around a little and surveyed me for a while and then he started striking me again.

Mr. Bender: Who was that?

The Court: Miller.

Mr. Marcus: Miller.

The Witness: Yes.

Q. (By Mr. Marcus): Were you knocked down?

A. Yes, he did.

Q. Did anything take place while you were knocked down?

A. Yes; he was kicking me all the time.

Q. Anything said to you about escaping?

A. He did. [420]

(Testimony of Refugio Gonzalez Lozoya.)

Q. Who? A. Mr. Miller.

Q. What did he say?

A. He said, "Let's give this guy a chance to escape." He says, "This way we can really have him."

Q. And then what did you say?

A. Well, I didn't say anything to it. I just stuck close to him all the time. I told him I loved my life too much to try to do that.

Q. Did you at any time make any statement or admission to them concerning this marijuana?

A. I never did.

Mr. Bender: Just a moment. The Government objects to that question and answer on the grounds that it is a conclusion of the witness.

The Court: No, the Officers testified that he didn't make any admissions.

Mr. Bender: Other than the tacit silent one, your honor.

The Court: Well, yes, but——

Mr. Marcus: Tacit silent one?

Mr. Bender: Well, the "shh" there, pointing to the fan, you recall.

The Court: Yes, but there was no admission. I will let it in.

You may answer the question. [421]

Q. (By Mr. Marcus): You were in the room with Mr. Ramirez, there, weren't you?

A. Yes, I was.

Q. Did he start talking to you?

(Testimony of Refugio Gonzales Lozoya.)

A. Yes, he did.

Q. What did you tell him?

A. I told him I didn't know the man at all, I never seen him before. I said, "I don't even want to have a word with you at all."

Q. Did you at any time tell him to "shut up"?

A. Yes, I did.

Q. Did you suffer any injuries as a result of this beating? A. Yes, I did.

Q. What happened to you?

A. Well, when the first officer struck me, he hit me on my head, on my face, and on my eyes, direct like that.

Q. What happened to your glasses?

A. They dropped, they fell, when he slapped me, my glasses flew off of my face.

Q. Did you suffer any permanent injury?

A. Yes, I did. I got a busted ear drum because of that. He hit me with the palm of his hand with full force in my ear.

Q. Did any of the officers talk between themselves after your being beaten? Did they say anything between themselves [422] that you heard?

A. No. Well, yes, Officer Cantu, I think it was, told him, "Don't mark him up," he says, "Be careful and don't mark him."

Q. Was your picture ever taken across the street? A. Never was.

Q. What was the condition of your eyes when you were booked?

A. I was all swollen up. My head and my ear

(Testimony of Refugio Gonzales Lozoya.)

was hurting at the time and—well, my legs were all bruised and swollen.

Q. How did you get your legs bruised?

A. Well, Mr. Miller, when he struck me, when he was striking me, he knocked me down and kicked me, and then he told me to get up and sit down again. So I did. Then he sat on the table in front of me there and all of this time he remained there trying to make me confess that the stuff was mine, the marijuana that he claimed it was. So he just kept on swinging his leg and kicking me all the time on my legs.

Q. He was sitting on the table and you were sitting in the chair?

A. That is right.

Q. And he swinging his legs and kicking you?

A. Just kicking me all the time, yes.

Q. What is the condition of your ear now? [423]

A. It is in very bad shape. I can't even hear through it. I have very poor hearing through it.

Q. Is there anything wrong with it now?

A. Yes, it is running all the time.

Q. Have you received treatment from a physician? Yes or No?

A. Yes, I had one treatment.

Q. At the county jail?

A. At the county jail.

Q. Did you have any discoloration of your eyes afterward?

A. Well, it discolored gradually, yes.

Q. You don't understand. Were your eyes black?

A. Yes, they were.

(Testimony of Refugio Gonzales Lozoya.)

Q. And you had bruises all over your head and legs?

A. Yes, sir.

The Court: Is that all?

Mr. Marcus you may cross-examine.

Cross-Examination

By Mr. Bender:

Q. You say both your eyes were black, is that correct? Is that what you just said?

A. Pardon.

Q. Isn't that what you just testified, that both your eyes were black?

A. No, sir; I had my——

Q. Didn't you just testify to that? Didn't you just say that both of your eyes were black? [424]

Mr. Marcus: I asked him the question, "Were your eyes black?"

The Court: There has been testimony only about one eye.

Mr. Bender: Would the reporter read the record? The question was, "Were your eyes black?"

The Court: Well, it is minor. In other words, the fact that one eye is black is shocking to the Court.

Mr. Bender: Your Honor, it would be shocking to us.

The Court: Yes.

Mr. Bender: If the circumstances were as the defendant claims.

The Court: All right, one eye was black there. You are only contending about one eye?

(Testimony of Refugio Gonzales Lozoya.)

The Witness: Yes.

The Court: That is all the testimony is about, one eye.

Mr. Bender: No, your Honor, on direct examination——

The Court: I think it was an honest mistake. I think Mr. Marcus was contending all along that it was just one eye that was black.

Mr. Bender: That is the point.

Mr. Marcus: My question was, "Were your eyes black?" and his answer is "Yes." That is all there is.

The Court: Yes, I think it is minor.

Q. (By Mr. Bender): Mr. Lozoya, on May 17, at about seven-thirty in the evening, was it dark? [425] A. Yes, it was.

Q. Did you have your headlights on in the car?

A. No, I did not.

Q. Did you observe any other cars with headlights on at this time?

A. No, I did not.

Q. What do you mean, it was dark?

A. Well, the evening was falling in, sir. It is just about time to turn on your lights, but I didn't have the necessity to put them on at the time.

Q. At any time in May, 1956, did you have conversation with Johnny Villas concerning a sale or transfer of marijuana? A. Never have.

Q. What about back around October, 1955, did you have any conversation with Mr. Villas?

A. I never have.

(Testimony of Refugio Gonzales Lozoya.)

Mr. Marcus: Just a moment. Don't answer that.

The Court: He says, "No."

Mr. Marcus: It is improper. There is no direct examination on that.

The Court: I know, but I will let the answer remain.

Mr. Bender: I don't believe the Government on cross-examination, is limited to what was gone into on direct examination, your Honor.

The Court: I let him answer the question. I said I [426] overruled the objection. He said, "No."

Q. (By Mr. Bender): What kind of automobile did you own on May 17, 1956?

A. I owned a 1941 Chevrolet.

Q. What color?

A. It is a cream light color.

Q. Did you own the same automobile back around October, 1955?

A. Yes, I did.

Q. What is it—a sedan?

A. Pardon.

Q. Is it a sedan?

A. It is a two-door sedan.

Q. A two-door sedan? Back on May 17, 1956, you testified that you met Johnny Villas at the intersection of Beverly and what other street?

A. What date was that?

Q. May 17?

A. Yes, sir.

Q. Where did you meet him?

A. I met him on Garfield and Beverly Boulevard.

Q. About how far is that from the intersection of Beverly Boulevard and Poplar Street?

(Testimony of Refugio Gonzales Lozoya.)

The Witness: I consider it about maybe three miles.

Mr. Bender: That was seven o'clock? [427]

Mr. Marcus: He doesn't hear very well, counsel.

Q. (By Mr. Bender): Was that about seven o'clock that you met him there?

A. At seven o'clock, yes.

Q. Right at seven?

A. Well, I was not looking at the clock at the time, but it was about seven o'clock.

Q. Now, directing your attention to the vicinity of the Beverly Ranch Market and specifically Beverly Boulevard where it intersects with Poplar Street, did you approach this intersection driving in an easterly direction on Beverly Boulevard?

A. Yes, I did.

Q. And that was Johnny Villas that was in the car with you? A. He was, yes.

Q. You were driving the car? A. I was

Q. Did you stop for a red light?

A. Yes, I did.

Q. What did you do after you stopped for the red light there?

A. Well, I made a right hand turn, and then I made a left hand turn and drove into the market through Poplar Blvd. or Poplar Street. [428]

Q. After you drove into this Beverly Ranch Market parking lot, where did you go?

A. After I drove there?

Q. Yes.

(Testimony of Refugio Gonzales Lozoya.)

A. I parked my car in front of Mr. Ramirez's car.

Q. Which direction was your car facing at this time? A. East.

Q. Which direction was his car facing?

A. Let see, that is south—north. North.

Q. North? A. Yes.

Q. Facing north? A. That is right.

Q. In the Beverly Ranch Market parking lot?

A. That is right.

Q. Did Agent Ramirez then have a conversation with you?

A. Well, I parked my car in front of his car and then I backed it in.

Q. Before you backed it in, didn't Johnny Villas get out of your car?

A. Well, he got off the car when I backed it in, yes.

Q. Didn't he get out of the car when you first stopped in front of the—— A. No, he didn't.

Q. You say he got out of the car when you backed it in. [429] While you were backing in, he got out of the car?

A. I was backing it in and he got off the car, and then I got off my car on the left-hand side and walked toward the front, and Johnny Villas went to Mr. Ramirez and then we met there at or about the front of the cars—not exactly in front.

Q. I'm sorry to stop you, but I just want an answer to the one question and not the whole transaction. Did you have a conversation with Agent

(Testimony of Refugio Gonzales Lozoya.)

Ramirez while your car was parked facing in an easterly direction in front of the Government Agent's car? A. No, I did not.

Q. Didn't Agent Ramirez come out, walk over there and talk to you at this time where you parked?

A. No, he did not.

Q. Then exactly how long was your car parked facing in an easterly direction before you backed it in?

A. Well, maybe half of second, just about half a second. It doesn't take very long.

Q. How did you recognize the Government Agent's car?

A. I didn't say I recognized the Government——

Q. How did you know to stop where you did stop?

A. Well, because Johnny Villas was in my car and he told me, "There is the fellow that wants to talk to you."

Q. At the time Agent Ramirez first spoke to you, did he [430] have a banana in his hand?

A. I never seen him eat anything.

Q. Never had a banana in his hand?

A. No, I didn't see it.

Q. Did he have an apple or any fruit in his hand? A. No, he did not.

Q. Well, at the time you had backed the car completely in there parallel with the Government car, was Johnny Villas still in your car?

A. At the time I backed in?

Q. Yes, at the time you stopped moving the car?

(Testimony of Refugio Gonzales Lozoya.)

A. Yes, he was. He didn't get off my car until I parked.

Q. And you didn't get out of your car either until you parked? A. That is right.

Q. Approximately how far, what distance separated your car and the Government's car?

A. Well, say, about three—

Q. At the time they were parked in a parallel position?

A. Say about three and a half or four feet.

Q. And approximately how much distance separated your car before you pulled it to a parallel position and when it was parked in front of the Government Agent's car?

A. When the car was facing east?

Q. Yes. [431]

A. How far apart it was from the Federal Car?

Q. That is right.

A. Well, I don't know, maybe about four feet.

Q. Didn't Agent Ramirez come up and have a conversation with you on the right-hand side of the car?

A. He never came to the right-hand side of my car.

Q. What about the left-hand side of your car?

A. He didn't come to the left-hand side of my car either.

Q. That is the driver's side, isn't it?

A. That is the driver's, yes.

Q. You were wearing your glasses at this time?

A. Yes, I was.

(Testimony of Refugio Gonzales Lozoya.)

Q. Did you have any conversation with Agent Ramirez? A. Yes, I did.

The Court: Just a moment.

(There was an interruption at this point.)

Q. (By Mr. Bender): Mr. Lozoya, did you have a conversation with Agent Ramirez in which he said to you, "Do you have something for me"?

A. No, I did not.

Q. Did he say anything in words or effect that would indicate, "Do you have something for me"?

A. No, he didn't.

Q. Did you say to him, "Yes, I have some llesca"?

A. I did not mention no such thing. [432]

Q. Did you say you had any marijuana?

A. No, I did not.

Q. Did you converse with him concerning the price of marijuana? A. I didn't get that.

Q. Did you talk with him about how much he would have to pay for marijuana?

A. No, I did not.

Q. From you? A. No, I didn't.

Q. Do you know what marijuana looks like?

A. No, I don't.

Q. Never seen it before? A. Well, no, sir.

Q. Never seen a marijuana cigarette?

A. Never have.

Q. Did you talk to Agent Ramirez that you were going to charge him sixty dollars a pound for marijuana? A. Never said no such thing.

(Testimony of Refugio Gonzales Lozoya.)

Mr. Marcus: That is objected to as having been asked and answered, your Honor.

Mr. Bender: No.

The Court: I will let the answer remain.

Q. (By Mr. Bender): Did you tell him you would sell him about ten pounds of marijuana for six hundred dollars? [433]

A. I never had any discussion concerning marijuana with Mr. Ramirez.

Q. Did you tell him you would sell him about ten pounds of stuff for six hundred dollars?

A. I never told him any such thing.

Q. Did he ask you about how much you would charge for selling him marijuana in the future?

A. No, he did not.

Q. Didn't you tell him that you might sell it to him for a little less than sixty dollars a pound?

A. There was no discussion of price or anything concerning marijuana, sir.

Q. Didn't you tell him that in the future you would perhaps let him have it for about fifty-three dollars a pound?

A. I never had said any such thing.

Q. Did you tell him you had to bring it across the border? A. Never had, sir.

Q. And that caused the price to be sixty dollars?

A. Never have.

Q. Did you get out of the car—your car?

A. Yes, I did.

Q. You got out on the left-hand driver's side?

A. That is right, sir.

(Testimony of Refugio Gonzales Lozoya.)

Q. Where did you go? [434]

A. I went around to the front of my car and I met Mr. Ramirez just about in the middle of, we will say, about half the size of the automobile, say about two or three feet from the front end.

Q. By "met him" you mean you were just introduced to him for the first time this time?

A. That is right.

Q. Had no conversation with him while your car was parked in front of his?

A. Never had; no, sir.

Q. He didn't walk up to you while your car was parked in front of his?

A. He walked up to me?

Q. Yes; did he? A. No, he did not.

Q. While the cars were parked parallel, what did you talk about?

A. Well, like I told you, I told him, I says, "Boy, you sure have a nice car, Mister."

He said, "Yes."

I said, "Are you still interested in buying my restaurant?" And he says, "I never been interested in buying any kind of business." He said, "What I want is marijuana."

I said, "What gives you the idea that I'm selling marijuana." [435]

So he says, "I will pay a good price for it if you get me some."

Q. Keep going—what else did he say?

A. Well, then he also said—let's see, what else was said.

(Testimony of Refugio Gonzales Lozoya.)

The Court: Well, you told us he showed you some money?

The Witness: Oh, yes, he raised his right hand into his left pocket in his shirt and pulled out a roll of bills and he says, "Look," he says, "I will pay a good price for it."

I says, "I don't have any such thing."

So at that time there was no more conversation because the Officers arrived.

Q. Well, hadn't someone, before the Officers arrived carried a bag from one car to the other car?

A. Not that I recall.

Q. Not that you recall? Did you see anyone do that?

A. No, I did not.

Q. Where was Johnny Villas at this time?

A. He was standing right there by us.

Q. Didn't Johnny Villas carry a bag from one car to the other?

A. No, he did not.

Q. Didn't Agent Ramirez carry that bag from your car to [436] his?

A. No, he did not.

Q. Did you?

A. No, I did not, sir.

Q. Did you see anybody carry a bag over there?

A. No, I did not, sir.

The Court: Anything else?

Mr. Bender: Yes, your Honor.

The Court: We will adjourn until tomorrow morning at 10:00 o'clock.

Mr. Marcus: Will you stipulate to the measurements?

Mr. Bender: I can't do that until I know the source of the measurements.

(Testimony of Refugio Gonzales Lozoya.)

Mr. Marcus: Well, they actually measured them with the tape. The party that measured them was out there.

Mr. Bender: If I can converse with him during the recess——

Mr. Marcus: I was trying to wind it up. I was trying to wind it up this evening.

The Court: I have been here all the time, Mr. Marcus. That is all I can do. I have been very patient in this case. I have been here three days now.

Make it 10:00 o'clock in the morning. Talk to your man out there. Maybe he will stipulate as to the measurements.

(Adjournment until Friday, July 20, 1956, 10:00 a.m.) [437]

Friday, July 20, 1956—10:00 A.M.

The Court: All right, you may proceed.

Mr. Marcus: Take the stand.

REFUGIO GONZALES LOZOYA

the defendant herein, called as a witness on his own behalf, having been previously sworn, resumed the stand and testified further as follows:

Cross-Examination

(Continued)

By Mr. Bender:

Q. Mr. Lozoya, did you push Narcotics Agent Gullon in the Federal Narcotics office?

A. No, I did not.

(Testimony of Refugio Gonzales Lozoya.)

Q. Did you strike him? A. No, I did not.

Q. Did anyone take your fingerprints there?

A. Yes.

Q. At the Federal Narcotics office?

A. Yes.

Q. Who took them? A. Agent Cantu.

Q. Who was present when he took them?

A. I believe it was—well, the officers at that time, they were all coming in and out in the office there as far as that goes. [438]

Q. You are not confusing this with having your fingerprints taken in the county jail are you?

A. Pardon?

Q. Did you have your fingerprints taken in the county jail? A. Yes, I did.

Q. How many times did you have your fingerprints taken? A. All in general?

Q. Yes.

A. Well, I took them once at the Federal Building here, and they took them twice at the county jail, and the officer took them once more here at the marshal's office over here.

Q. In fact, hadn't Agent Gullon asked you to submit to having your fingerprints taken when you pushed him? A. Pardon?

Q. Hadn't Agent Gullon asked you to submit to having your fingerprints taken when you pushed him?

A. No, he never asked me to take my fingerprints at all.

(Testimony of Refugio Gonzales Lozoya.)

Q. That is when you pushed him?

A. I never pushed Mr. Gullon.

Q. At the Beverly Ranch Market on May 17th, how many Agents arrived with drawn guns?

A. Well, I could see, three or four of them.

Q. All had their guns out?

A. That is right, sir. [439]

Q. Who?

A. Well, the officers who were involved.

Q. Did Agent Ramirez have his gun out?

A. No, sir, he didn't.

Q. Did Agent Gullon have his gun out?

A. Yes, he did.

Q. Did Agent Freeman have his gun out?

A. No; I don't believe so. I don't think I even saw the man there close.

Q. Did Agent Goodman have his gun out?

A. Yes; he did.

Q. Now, you had just gotten out of your car, is that correct, when you were arrested?

A. That is right.

Q. And you just parked it there parallel with the Government's car?

A. Yes; I did.

Q. Had you turned off the ignition?

A. Yes; I did.

Q. What did you do then?

A. I got off the car.

Q. What about the keys to the car?

A. They remained in the car.

Q. Did Villas get out of the car before you did?

(Testimony of Refugio Gonzales Lozoya.)

A. Well, we both got off just about the same time. [440]

Q. Did he take the keys?

A. No; he did not.

Q. Was your trunk locked?

A. Yes; it was.

Q. When did you lock it?

A. My trunk remains locked at all times, sir.

Q. When did you lock it before this occasion?

A. Well, that I can't remember. I haven't opened—used my trunk for quite some time.

Q. Was it locked when you drove the car into the Beverly Ranch Market?

A. It was locked; yes, sir.

Q. Well, was your trunk opened at the Beverly Ranch Market at any time before you were placed under arrest?

A. It was opened afterward; yes, sir.

Q. Was it ever opened before you were placed under arrest?

A. No; it was not.

Q. What is the farthest distance you got away from your car at the Beverly Ranch Market parking lot before you were placed under arrest?

A. Well, I will say maybe a foot, a foot and a half—one foot—I mean we were close by all the time.

Q. When you were at the Beverly Ranch Market, did you know Agent Ramirez was a Treasury Agent?

A. No; I did not. [441]

Q. On May 17 when you were in the interrogation room of the Federal Narcotics Office, did you

(Testimony of Refugio Gonzales Lozoya.)

then know that Agent Ramirez was a Treasury Agent? A. No; I did not.

Q. When you were alone in this interrogation room with Agent Ramirez, you remember he started to talk to you about the marijuana?

A. Yes; I remember him saying something like that.

Q. And didn't you shush him?

A. I never said no such thing.

Q. Didn't you point to the fan on the wall?

A. No; I did not.

Q. What did you do?

A. I just stood there. He tried to talk to me into saying something that was not so.

Q. You just stood there?

A. That is right.

Q. You didn't say anything?

A. I told him to shut up.

Q. What else did you say? A. That is all.

Q. Well, on direct examination, you remember yesterday you said, "I don't want to have a word with you at all." Do you remember that?

A. Well, I told him that I didn't want to talk to him; [442] to shut up. That is all I said.

Q. "I don't want to have a word with you at all"?

A. Well, technically, it means that I didn't want nothing to do with him.

Q. You didn't find out that he was a—that Agent Ramirez was a Treasury Agent until May 24, over at the County Jail, didn't you?

(Testimony of Refugio Gonzales Lozoya.)

A. That is correct.

Q. That is when he came in and made demands on you for this order form?

A. That is correct.

Q. From the Secretary of the Treasury?

A. Yes, sir.

Q. Do you remember telling him that you had the form? A. That I had a form?

Q. Yes.

A. No; I don't remember saying any such thing, sir.

Q. Do you further remember his telling you that you had eight days in which to produce it?

A. I remember him telling that; yes, sir.

Q. And you remember yourself saying then, "Well, I don't have an order form"?

A. No, sir; I didn't say that.

Q. Did you say that you did have an order form?

A. I didn't say I had an order form at all. [443]

Q. What did you say when he asked you if you had an order form?

A. I just told him, I said, "You give this to my lawyer. I ain't signing no papers." So then he told me, he said, "You don't have to sign."

Q. Did you tell him you had an order form?

A. No, I told him I didn't have one at that time.

Q. On the way to the Federal Building with Agents Gullon and Miller, didn't you tell them you were a little hard of hearing?

A. No, sir, I did not.

(Testimony of Refugio Gonzales Lozoya.)

Q. That you were having trouble with your ears?

A. No, sir.

Q. Did one of the Agents ask you if you were hard of hearing?

A. No one ever asked me anything.

Mr. Bender: No further questions.

Redirect Examination

By Mr. Marcus:

Q. On your way to the County Jail from the Federal Building you had some injury to your ear at that time, didn't you?

A. Well, when I got struck there in the office there, my head was all like, well, sore, you know, and——

The Court: Well, he has covered that.

Mr. Marcus: All right. [444]

That is all. Step down.

The Court: Were you able to stipulate on the distances last night, Mr. Bender? Did you and Mr. Marcus talk with the man in the hall?

Mr. Bender: About the distances?

The Court: Yes.

Mr. Bender: It was a lady, I don't think we were, because she didn't take the measurements.

Mr. Marcus: Well, that isn't so important.

The Court: Do you want to put somebody on about the measurements, or do you need to?

Mr. Marcus: Well, I can put the witness on now for the measurements.

The Court: Is he here?

Mr. Marcus: Yes.

The Court: All right, have him take the stand, or is that your case, Mr. Marcus?

Mr. Marcus: No, I have another witness for a few questions.

The Court: All right.

(Mr. Marcus leaves the Court Room momentarily and returns with a witness.)

Mr. Marcus: Take the stand. [445]

MARY CATHERINE MACIAS

called as a witness for the defendant, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Marcus:

Q. I will direct your attention to this gentleman seated at the to my right. I will ask you if you have ever seen him before?

A. The only time I saw him was that night that the trouble happened.

Q. The night the trouble happened?

A. Yes.

Q. Did you ever know this man or hear of him before that night? A. No.

Q. You are not personally acquainted with him?

A. No, I am not.

Q. Have you ever talked to him?

A. Not before that, no. Now I have.

Q. Well, today you have?

(Testimony of Mary Catherine Macias.)

A. Not today I haven't talked to him.

Q. But you are not personally acquainted with him, are you? A. No, I am not.

Q. Where did you live on May 17, 1956? [446]

A. 432 North Poplar, Apartment B.

Q. Apartment B, 432 North Poplar?

A. Yes.

Q. Speak a little louder, please.

Where is this house that you lived in with reference to Beverly and Poplar Street?

A. Well, it's the third apartment from the front going back—third apartment back.

Q. Is this house located to the rear of the Beverly Market? A. Yes.

Q. What is the full name of this market?

A. Beverly Fair Ranch Market.

Q. You live in the third apartment. Is that Apartment B you said?

A. That is Apartment B, yes.

Q. Will you step down to this board, please, and just point out where you live?

This is Poplar Street, this is Beverly Boulevard, this is the Ranch Market, this is the service station. Now where is your house?

A. It is right about here (indicating).

Q. Wait a minute; we will mark that with an X. Mark it with an X-A.

A. (The witness marks the diagram.) [447]

Q. We will mark this X-1. That is where your apartment is? A. Yes.

Q. Speak louder so the Judge can hear you.

(Testimony of Mary Catherine Macias.)

A. The back door is just a little bit behind the end of the market.

Q. The market building you mean?

A. Yes.

The Court: Ask her leading questions so that you can speed it along.

Q. (By Mr. Marcus): Did you see any cars parked there that evening?

A. Yes, I saw a 1952 Mercury, black, and then it was parked there quite a while, and then I saw the Chevy come in.

Q. You saw a Chevy come in? A. Yes.

Q. Didn't you see it park?

A. Park where?

Q. The market place where both cars were?

A. This here is the Mercury (indicating) and this here is the Chevy (indicating).

Q. Was your husband's car parked there, too?

A. Yes; he was next to the Chevy.

Q. Right there? A. Yes. [448]

Q. That is the approximate area where they were parked? A. That is just about it.

Q. Take the stand. Did you see anybody get out of the Chevy? A. No, I didn't.

Q. Did you see anybody in the Mercury?

A. Yes.

Q. Your back door is how many feet from where those cars were parked? A. Sixteen feet.

Q. How long were the cars there before you saw any excitement or any men run up there?

(Testimony of Mary Catherine Macias.)

A. Both of them were there about two or three minutes.

Q. Two or three minutes? A. Yes.

Q. Then what did you see happen?

A. A lot of men came up and I went outside.

Q. Where had you been before that?

A. I was in the kitchen there.

Q. Tell the court whether or not from your kitchen there you can see what is going on there?

A. Yes.

Q. Did you at any time see any person before the men came up take anything out of one car and put it in another car? A. No, I didn't. [449]

Q. Were the trunks of both cars facing your back door? A. Yes.

Q. Could you see them?

A. I could see the Chevy and a little bit of the Mercury.

Q. Did you see anybody open any trunks of either of those two cars before the men came up?

A. No, I didn't.

Q. When is the first time you saw the trunks opened?

A. When a man opened the trunk of the Mercury.

Q. What man was it that opened the trunk of the Mercury? A. I don't know his name.

Q. Have you seen him around this courtroom?

A. Yes.

Q. Have you ever been in a courtroom before

(Testimony of Mary Catherine Macias.)

and testified? A. No, I haven't.

Mr. Marcus: Is Mr. Goodman here, counsel?

Mr. Bender: No, your Honor, I don't see him.

Q. (By Mr. Marcus): Did you hear any conversation at that time? Did you hear anybody talking?

A. At the time the men came, or before the men came?

Q. Before the men came?

A. No, I didn't

Q. You heard no conversation? A. No.

Q. Did you hear any conversation after the men came? A. Yes. [450]

Q. What did you hear, to the best of your memory?

A. Well, the men got out of the car—the men that came up got out of the car.

Q. You saw them get out of the car?

A. Yes, and they came over and they pulled their guns—they had guns.

Q. Did you see guns? A. Yes.

Q. Are you sure you saw guns?

A. Yes, I saw guns.

Q. Then what?

A. Then they started cussing.

Q. Wait a minute. What did you hear them say?

A. Do I have to say it?

Q. Don't you want to say it? A. No.

Q. All right, if there is no objection, you won't have to say it. You heard cuss words? A. Yes.

(Testimony of Mary Catherine Macias.)

Q. And what did you hear besides the cuss words?

A. They asked the man that went and got the keys from this man here and——

Q. You saw some man get some keys from Mr. Ramirez?

That is his name. [451]

A. Yes, Mr. Ramirez.

Q. Do you recognize seeing this man here—Mr. Ramirez, there? A. Yes, I do.

Q. You saw him? A. Yes.

Q. And some man that came up there took some keys from this man? A. Yes.

Q. What did he do with the keys?

A. He went and opened up the back trunk of his car, the one Mr. Ramirez was in, he opened the trunk and he got a green sack out and he asked them—well, he was cussing and he asked him what he thought it was, and he said he didn't know.

Q. And Mr. Ramirez said he didn't know?

A. Yes.

Q. Then what happened?

A. They just kept going back and forth.

Q. Did you see Mr. Lozoya there?

A. Yes, I did.

The Court: Here is Mr. Goodman now.

Mr. Marcus: Oh, yes. Will you stand up, Mr. Goodman?

(Mr. Goodman stands.)

Q. (By Mr. Marcus): I will ask you if you have seen this man before? [452]

(Testimony of Mary Catherine Macias.)

A. Yes. That was the day it happened. He was the one that opened the trunk of the black car.

Q. Did you hear him use any cuss words?

A. Yes.

Q. Is he the one that used the cuss words?

A. Yes.

Q. Now, did you hear Mr. Lozoya say anything there?

A. He said he didn't know anything about it.

Q. Who asked him a question, that he gave that answer?

A. There were a lot of men there. I can't recall if one asked him, but I know he said he didn't know anything about it, and that is all that one time. I thought that Mr. Ramirez was the one that was in trouble.

Q. Then Mr. Lozoya said he didn't know anything about it; is that his words?

A. That is correct.

Q. And then did they leave there?

A. Yes, they said, "Well, we better get going" or something like that, and they all left.

Q. Were there many people around at the time?

A. My neighbors were looking out.

Mr. Marcus: You may cross-examine.

(Testimony of Mary Catherine Macias.)

Cross-Examination

By Mr. Bender:

Q. Mrs. Macias, about what time did [453] you first see the black Mercury convertible parked outside of the kitchen window?

A. It was around four-thirty when my husband got home from work.

Q. Four-thirty? A. Yes.

Q. Was that the same convertible that you saw later? A. Yes.

Q. Did it stay there all that time?

A. Yes, it did.

Q. Did you see it there at about seven o'clock?

A. Yes.

Q. Did you see it drive up about seven o'clock?

A. I didn't see it drive up.

Q. You didn't see it drive up at four-thirty either did you? A. No, I didn't.

Q. You don't know when it first arrived?

A. No, I don't.

Q. Who was driving it when it arrived?

A. Nobody was driving it. He was sitting there.

Q. When did you first see him sitting in the car?

A. Four-thirty.

Q. Did he stay in it from four-thirty on?

A. As far as I know, yes. It was there every time I looked [454] out or every time I went out of the house.

Q. When did you look out the next time?

A. I went back in the back. I don't know what time it was. I went quite a few times in the back.

(Testimony of Mary Catherine Macias.)

Q. Did you look out about five o'clock?

A. I don't know what time it was. I know I went out to the line and got the clothes down, and I went back to a girl friend's house. I don't know what time it was.

Q. You didn't know Agent Ramirez testified that he arrived there about seven o'clock.

A. I didn't know he testified to that? No, I don't.

Mr. Marcus: What he testified to is immaterial to this witness.

The Court: Yes, I will overrule the objection.

Q. (By Mr. Bender): Were you looking out the window all the time that the car was there?

A. No, I was not looking out the window all the time.

Q. You say that this back door of yours is a little to the east of the easterly edge of the Beverly Ranch Market?

A. It was right there where I put it.

Q. Without looking at the blackboard, can you tell us whether it is farther in a more easterly direction?

A. What do you mean?

Q. Than the side edge of the Beverly Ranch Market?

A. What do you mean? [455]

Q. Is it further off of Poplar Street than the edge of the Beverly Ranch Market?

A. Is it farther off of Poplar Street?

Q. Farther east?

A. No, I think going toward Beverly that my door is farther than it is from Poplar.

Q. But going down east on Beverly is your door

(Testimony of Mary Catherine Macias.)

farther east than the edge of the market building itself?

A. No, my door is right behind the corner of the market.

Q. And when you look out your window to look at the black Mercury, which direction did you look? Did you look to your right?

A. The Mercury was right on the side. My door is here, and the Mercury was right (indicating).

Q. A little bit to your right? A. Yes.

Q. Where was the Chevrolet?

A. Right next to the Mercury.

Q. That was a little bit to the left of the Mercury wasn't it? A. That is right.

Q. In other words, it was in a westerly direction?

A. Yes.

Q. Did you see the Chevrolet stop in front of the black Mercury? [456]

A. Not in front of it.

Q. Where did you see it stop?

A. Right on the side of it.

Q. Did you see it being driven into the market?

A. I saw it when it was just coming in like that, backing in.

Q. When you say just coming in, you saw it?

Mr. Marcus: She said backing in.

The Witness: Backing in.

Q. (By Mr. Bender): In other words, you saw it being backed in? A. Yes.

Q. You didn't see it before it was backed in, did you? A. No, I didn't.

(Testimony of Mary Catherine Macias.)

Q. Or being backed in?

A. I saw it when it was being backed in.

Q. You don't know then whether it stopped in front of the Mercury for any period of time and then was backed in?

A. I would have noticed it, because you can hear any car that comes up right away.

Q. Did you see it stop in front of the Mercury?

A. Not in front of the Mercury, no.

Q. Did you see it when it was first driven into the Beverly Ranch Market parking lot?

A. Yes, because he was backing in. [457]

Q. Where was it when you first saw it?

A. It was coming like this (indicating).

Q. It was how far away from you?

A. Sixteen feet, that is—it was backing in.

Q. It was backing in; is that correct?

A. Yes, it was coming like this.

Q. You didn't see it going forward at any time did you? A. No.

Q. What were you doing in the kitchen at the time you saw the car being backed in?

A. The dishes.

Q. Were you looking at the dishes from time to time? A. Yes, when I was watching them.

Q. Then you would look at the dishes and glance out the window, and look back at your dishes?

A. Yes.

Q. Which did you look at more of the time, the dishes or out the window?

A. I was looking ahead.

(Testimony of Mary Catherine Macias.)

Q. Which did you look at most of the time?

A. I suppose I was looking out. I don't know which I was looking at most of the time. I guess my dishes, what I was doing. But then I——

Q. But of course you would look out of the window on occasions, didn't you? [458]

A. Yes.

Q. At the time you looked at the window and saw the car being backed in and parked parallel with the Government black Mercury, did you look at that car continually from that moment until the officers made the arrest?

Now, this is important.

Mr. Marcus: I don't know how important you believe it is, counsel, but that has been asked and answered.

Mr. Bender: Not by me.

Mr. Marcus: You are talking about the black Mercury?

The Court: I will let her answer.

Mr. Bender: I am talking about the Chevrolet.

The Court: I overruled the objection.

Mr. Bender: Would you like the question asked again?

The Witness: Please.

Q. (By Mr. Bender): From the time you first saw the Chevrolet automobile being backed in and parked next to the Mercury, did you look at it without interruption, never looking back to your dishes or elsewhere until the Federal Narcotics Agents came with guns as you said?

(Testimony of Mary Catherine Macias.)

A. I was waiting to see who was going to get out of the car.

Q. But did you look at it all during that time, or did you at any time look back to your dishes?

A. Yes, I did look back to my dishes, but not long [459] enough where somebody could get out.

Mr. Marcus: I move to strike the answer as being not responsive to the question.

The Court: It may go out.

Q. (By Mr. Bender): Did you look back at your dishes several times? A. When?

Q. After the Chevrolet had been parked parallel to the Mercury?

A. Not too much. I was putting the dishes up in the cupboard then. My husband was helping me.

Q. Did you have any particular interest in this Chevrolet or Mercury?

A. I was just wondering how come it was sitting there so long.

Q. You were just casually watching it?

A. Yes, just being nosey.

Q. You had no particular knowledge that there was going to be any arrest made or anything?

A. That was the farthest thing from my mind.

Q. Did you at any time see the trunk of the Chevrolet lifted up and closed?

A. No, I didn't.

Q. You testified, if my memory serves me correctly, that you could only see part of the black Mercury? [460]

(Testimony of Mary Catherine Macias.)

A. Yes, from the kitchen.

Q. From the window you were looking out of?

A. Yes.

Q. This car that you say drove up and people got out of, that was not this Chevrolet or this black Mercury that drove up, was it? A. No.

Q. That was another car? A. Yes.

Q. And Federal Agents or at least men got out of that car? A. Yes, men got out of the car.

Mr. Marcus: Louder, please. I don't hear a word.

The Witness: Yes, men got out of the car.

Q. (By Mr. Bender): Did you see a man with a gun at the scene?

A. At the time the men came up?

Q. Yes. A. Yes.

Q. Whom did you see?

A. Mr. Goodman, I guess his name is.

Q. Mr. Goodman you guess? Did you see anyone else?

A. There were a couple of guns and I don't know which one was holding them. I know I saw the guns.

Q. You saw the guns, or just one gun? [461]

A. Two guns.

Q. Who was the other person that was holding it? A. I can't recall.

Q. At this time did you know the gentleman seated to my right at the counsel table was a Treasury Agent?

A. No, I thought he was the one that was in trouble.

(Testimony of Mary Catherine Macias.)

Q. Did you also observe the defendant Lozoya placed under arrest?

A. Yes, I knew they had taken him.

Q. So you thought he was in trouble also?

A. I didn't pay too much attention. I paid more attention to him.

Q. You were looking more at Agent Ramirez at the time? A. Yes.

Q. Was this dark when this happened?

A. It was just getting dark. It was not dark. You could see clear across the street.

Q. You could see clear across the street?

A. Yes.

Q. From where you were over to the service station, couldn't you?

A. If I stood over more, yes. I could see the end of the service station where the——

Q. From your window? Could you make out any of the pumps? [462]

Mr. Marcus: Wait a minute. She was not finished.

The Witness: I couldn't see any pumps from my window. I could see the gas station building from my window.

Q. (By Mr. Bender): The Pumps were outside of your view; is that correct?

A. I couldn't see none of that.

Q. Did you see a car across the street over at the service station?

A. No, I didn't pay any attention to that.

Q. Did you see any men standing on the side-

(Testimony of Mary Catherine Macias.)

walk in between where you would look over to the service station? A. No.

Q. Were you paying any attention to that?

A. No.

Q. Could you see the sidewalk which ran parallel on Beverly Boulevard along the edge of where the parking area is to the Beverly Ranch Market?

A. On Beverly Boulevard, could I see the sidewalk?

Q. Yes.

A. I couldn't see the sidewalk in front of the market.

Q. But you could see the sidewalk which extended to the street from the market?

A. Yes, some of it.

Q. From your window? A. Yes. [463]

Q. You testified that you saw Agent Goodman, the gentleman sitting in the second or third row?

A. Yes.

Q. At the scene of the arrest? Did you see him go to the government car and take out the burlap bag? A. What is a burlap bag?

Q. I will show you a portion of Government's Exhibit 1. A. The green bag?

Q. Well, green and brown, various colored bag. Did you see him take a bag that resembles this one out of the trunk of the car?

A. It looks like a green bag.

Q. Did you see him? A. Yes, I saw him.

Q. What did he do with it?

A. He set it down. He took it out of the trunk

(Testimony of Mary Catherine Macias.)

and he set it down and he opened that bag and there was a bunch of little bags inside.

Q. A bunch of little paper bags?

A. They looked like cloth bags from where I was. They reminded me of the money that is put in the Brinks truck.

Q. Did you go up and inspect them?

A. No, I didn't.

Q. You said it looked like?

The Witness: Yes. [464]

Q. (By Mr. Bender): Did they look something like what I have in my hand, a portion of Government's Exhibit—

A. No. They took them out real fast and put them back in.

Mr. Marcus: I didn't get the answer.

The Court: "No. They took them out real fast and put them back in."

Mr. Marcus: Counsel asked her did they look like that paper bag. Was there an answer to that?

Mr. Bender: Yes, she said that.

Mr. Marcus: Did you answer that? Did they look like that paper bag you saw taken out?

The Witness: No, they looked like little flour sacks to me—cloth bag.

Q. (By Mr. Bender): You say they took them out real fast and put them back? A. Yes.

Q. You were not paying any attention to that at that time? A. Yes, I was paying attention.

Q. Where were you standing?

A. Outside.

(Testimony of Mary Catherine Macias.)

Q. How close?

A. Well, off my porch and about the middle of the driveway. I was pretty close. [465]

Q. Who took these bags out?

A. Mr. Goodman.

Q. Didn't he go up with the big bag, the big gunny sack to the defendant and talk with the defendant Lozoya? A. Mr. Ramirez—he did.

Q. Didn't he talk with Mr. Lozoya at all?

A. Not that I know of.

Q. Did you watch him all of the time he was there?

A. Most of the time. Well, I was wondering what was in there.

Q. Didn't you hear him, in words or effect, when he went up to defendant Lozoya, say, "Where did you get this god damn bag"?

A. No, he asked Mr. Ramirez and he was cussing and he asked him what he thought was in the bag and he was cussing, and Mr. Ramirez said, "I don't know."

Q. You didn't hear him at any time ask the defendant Lozoya what was in the bag or where he got the bag?

A. I can't remember if he did or not. I can't answer that.

The Court: Is that all?

Mr. Bender: I think that is all, your Honor. Just a moment.

(A pause.)

(Testimony of Mary Catherine Macias.)

Q. (By Mr. Bender): Did you finish doing your dishes [466] before you went out?

A. No. Well, most of them—the dishes were almost done. It was just the rest of the cleaning.

Q. Was your husband home?

A. Yes, he was helping me.

Q. Was he looking out the window?

A. Yes.

Mr. Bender: No further questions.

The Court: That is all.

Mr. Marcus: That is all.

The Court: Step down.

Is that your case?

Mr. Marcus: Yes, your Honor.

The Court: The defense rests?

Mr. Marcus: Yes.

The Court: Anything further?

Mr. Bender: I believe the Government may put on a rebuttal witness. May I have a moment?

The Court: Well, let's go. We can't take a recess.

Mr. Bender: I don't mean a recess. I mean a moment.

The Court: Well, put him on, whatever it is.

Mr. Bender: The Government calls Agent Miller.

ROBERT E. MILLER

called as a witness for the plaintiff, being first duly sworn, was examined and testified as follows: [467]

The Clerk: State your full name, please.

The Witness: Robert E. Miller.

Direct Examination

By Mr. Bender:

Q. Mr. Miller, what is your business, profession or occupation? A. Federal Narcotic Agent.

Q. Were you so employed and engaged on or about May 17, 1956? A. Yes.

Q. On that occasion, on that date, did you strike the defendant Lozoya? A. No, sir.

Q. Have you ever struck the defendant Lozoya?

A. No, sir.

Q. Do you recognize the defendant Lozoya?

A. Yes.

Q. Who is he?

A. The gentleman seated at the table to my right in the blue nylon shirt.

Q. Were you present at the scene of the arrest of the defendant Lozoya on May 17, 1956, at the Beverly Ranch Market? A. Yes, sir.

Q. Were you one of the Federal Narcotics Agents who took the defendant Lozoya into the Federal Narcotics office [468] that evening?

A. Yes, sir.

Q. Who else was in the car?

A. Agent Gullon.

(Testimony of Robert E. Miller.)

Q. Do you recall any conversation between Agent Gullon and this defendant?

A. Well, most of the conversation was on the part of Agent Gullon.

The Court: I don't know as that is rebuttal, is it? He should have testified on direct examination.

Mr. Bender: This goes to show, your Honor, it bears on the question of the defendant having said that he became hard of hearing after he was boxed on the ear.

Mr. Marcus: That isn't important. It is immaterial.

The Court: Go ahead. It is quicker to hear it than to have a dispute.

Mr. Bender: The Government has no further questions, your Honor.

The Court: Step down.

Mr. Marcus: That is all.

The Court: Does the Government rest?

Mr. Bender: Yes, your Honor.

The Court: Do you want to comment at all? The court is prepared to make its decision.

Mr. Bender: Well, your Honor, it depends, of course, [469] upon what the court's decision is. The Government feels very strongly that the evidence has shown in this case quite conclusively that the defendant is guilty. Also, the Government has about five cases which we would like to cite to the court, if the court has any doubt at all about the custody of the narcotics involved here.

The Court: I have let that exhibit in. The court let in Exhibit 1.

Mr. Bender: Yes, your Honor. I have all those cases to make certain there wouldn't be any doubt in the court's mind.

The Court: Well, it is all in evidence.

Mr. Bender: With reference to the evidence, aside from the question of the marijuana involved, I am assuming now that the court—that there is no doubt at all in the court's mind but that it was marijuana which was obtained in the parking lot at the Beverly Ranch Market; that the marijuana was what the Narcotics Agents testified that they obtained, that they had marked the packages.

The Court: There is no question about that.

Mr. Bender: Then the major point that the Government makes is that at this time Agent Ramirez testified unequivocally to the transfer of this bag by the defendant from his car to the government car. Agent Goodman observed it, Agent Gullon observed it, and Agent Freeman observed the lid of the trunk go up, before Agent Freeman started his route [470] through the market to take up his position for the arrest. These four Federal Narcotics Agents observed this. The defendant Lozoya has unequivocally denied that anyone, including Lozoya, Villas or Ramirez took anything out of the trunk of his automobile and denied that he placed it in the trunk of the Government automobile. This is a flat contradiction of the testimony of the four Narcotics Agents, who are trained to observe who were present, and testified unequivocally to this.

The defendant having transported and transferred this marijuana into the Government car is guilty as charged.

Mr. Marcus: Judge, I'm not going to——

The Court: Mr. Marcus, you don't need to comment, because the court has made up its mind. I feel, in view of the denial by the defendant and no further proof, the defendant is entitled to the benefit of the presumption. The court will find the defendant not guilty on both counts.

Mr. Bender: What presumption is he entitled to, your Honor?

Mr. Marcus: The presumption of innocence.

Mr. Bender: Would the court set aside its ruling long enough for the Government to——

The Court: The court has ruled. It has found the defendant not guilty on both counts. What further is there for the Government to say? [471]

Mr. Bender: On the evidence present, it appears that this is the clearest case of guilt that has been presented in these Federal Courts.

The Court: I'm sorry, the court feels differently.

Mr. Bender: Your Honor, I didn't understand the basis of the court's presumption.

Mr. Marcus: I think it is presumptive of counsel to ask the court for an explanation for the court's decision. I have practiced law many years——

The Court: Well, Mr. Marcus, we have to be tolerant with youth, you know.

Call the next case, please. [472]

Thursday, January 10, 1957—10:00 A.M.

The Court: This Lozoya case is first.

The Clerk: No. 25033—Criminal, United States of America vs. Refugio Gonzalez Lozoya.

Mr. Marcus: Shall we proceed, your Honor?

The Court: Do you want to proceed?

Mr. Bender: Yes, your Honor, but in view of the fact that the Government is not the moving party, I assume that you will hear from Mr. Marcus first?

The Court: Yes; I will hear from Mr. Marcus.

I am going to write an opinion in this case, counsel, but I haven't had a chance to do so yet as I have been working every day. I will when I come back, but I will give you the judgment of the court. I will write an opinion when I return, when I have time, but I don't see how I can do it now.

Mr. Marcus: Your Honor, the petition in this case has not been denied or traversed in any way. We, therefore, must accept the allegations of this petition as true.

It appears in this matter that the narcotic officers of the Narcotic Division of the Government of the United States and the employees of the Federal Government, as your Honor well knows, caused the arrest and prosecution of this defendant before the Federal Court. This trial [3*] took some time with the end result that the defendant was found not guilty of the charges against him.

Subsequent thereto, and after his discharge from custody, the same narcotic officers caused a com-

***Page numbering appearing at top of page of original Reporter's Transcript of Record.**

plaint to be filed in the State court, as alleged in this petition, signed and verified by the officer or the principal witness in the Federal Court and a Federal officer.

Pursuant to that complaint, a warrant was issued in the State court causing the arrest of the respondent and since the time of the arrest he has been incarcerated in the custody of the Sheriff of Los Angeles County.

The petition here further alleges that the Federal officers intend to testify in the State court and that the State case will be made upon the testimony of the Federal officers.

It is further alleged that the same testimony as adduced in the Federal Court hearing will be adduced in the State court.

We have cited in our petition the Rea case. We sincerely believe that the instant matter is a much stronger case, involving a violation of the defendant's constitutional rights, than the Rea case.

In the Rea case there was an unlawful search and [4] seizure and a suppression of the evidence.

In the instant matter, this court found the defendant not guilty, after a trial of the action. Now, he was found not guilty of the charge as alleged in the petition, as alleged and referred to in the Indictment filed in the Federal Court, and as alleged in the petition the same facts as contained in the Federal charge are also contained in the State charge.

The Court: Well, I am familiar with it, Mr. Marcus, and I will hear what the Government has to say.

Mr. Marcus: Thank you, your Honor.

Mr. Bender: Your Honor, opposing counsel contends that the petition of Lozoya has not been denied in any way, and the exact converse is true.

Paragraphs XVIII and XIX of the petition state in substance that constitutional rights of the petitioner have been violated or would be violated by testimony of the narcotic officers in the State court trial, and, of course, the brief by the respondents filed in opposition to the order to show cause clearly negate and controvert this assertion by the petitioner. In fact, we ask the one question, what right would be controverted, what right would be infringed, of petitioner Lozoya, if Federal narcotic officers testify as they should in State court proceedings? The answer is "No right"; opposing [5] counsel can point to no right that would be infringed.

Parenthetically, first on the Order to Show Cause it is the Government's understanding that it should have been filed as a civil matter and in view of the fact that there are no criminal proceedings pending in your Honor's court, it is improperly filed and improperly before this court and that the Chief Judge, who is the Judge handling such criminal matters, is the person before whom an order to show cause of this nature should be brought.

Placing that aside for the moment, it is the Government Respondents' contention that, in the absence of clear proof of a violation of Lozoya's rights by the Federal narcotics agents, no court has ever purported to have jurisdiction to enjoin the

agents from testifying. A Federal Court must have a valid cause, a violation of a Federal law before a judge of the court takes jurisdiction over the Federal narcotics agents and orders that they be enjoined from testifying.

Now, there is no unlawful search and seizure alleged in the instant Lozoya case. If it were alleged, it surely properly would have been alleged and raised in the trial court before your Honor, in Federal court proceedings. It is not raised.

The marijuana was validly, lawfully obtained by the Federal narcotic agents in performance of their duties. [6] As a matter of fact, there has never been a contention by Lozoya that it was his marijuana, and that is the indispensable predicate upon which any action to suppress evidence is brought. A person must claim that it is his, wrongfully taken from him, as in the Rea case where it was unlawfully searched and seized because there was a search warrant that was not valid. The Government admitted that in the Federal proceedings and as a consequence dismissed the Federal proceedings. Then, subsequently the State court proceedings was brought and the Federal narcotics agents, having unlawfully obtained that evidence, were subject to the jurisdiction of the Federal Judge and were amenable to an order to enjoin them from testifying in a State court proceeding.

The Court: Well, I have given a lot of thought to it, Mr. Bender, and I am going to file a written order.

Mr. Bender: Your Honor, the Government has

not had an opportunity to finish its argument, if it may.

The Court: All right.

Mr. Bender: Considering the Rea case, your Honor, and your Honor, of course, has read that case; it concerns simply an extension of Federal Criminal Rule 41(e), which permits a District Court to suppress evidence obtained by unlawful searches and seizures. The entire basis of the authority of the court there to act was based upon the [7] violation of law by the Federal narcotics agents in obtaining the evidence of marijuana. There is no similar violation by the Federal narcotics agents in this case.

That Rea case, if anything is authority for a denial of the attempt to enjoin these Federal narcotics agents from testifying in the State court. The Rea case states: The Federal Court may enjoin the Federal officer from using "the fruits of his unlawful act" as "the basis of testimony in the state court."

I ask, your Honor, and I challenge the petitioner to show us the unlawful act of the Federal narcotics agents in this case.

In the absence of acquisition of the marijuana by Federal agents by unlawful search and seizure, the provisions of 26 U.S.C. 2598(d) apply and give the Secretary of the Treasury alone the power to destroy or deliver marijuana to the Narcotics Bureau, as we have set out in paragraph III of our brief in opposition to the order to show cause.

Further, the Secretary of the Treasury, by T. D. Order 28, has provided that the Secretary of the

Treasury delegates to the Commissioner of Narcotics the authority and jurisdiction over all marijuana.

Now, certainly by judicial construction 26 U.S.C. 2598(d) would have no force and effect as counsel for [8] petitioner contends would be allowed to prevail, to the effect that this court could order the destruction of that marijuana, where there has been no violation of any Federal statute of law by anyone concerned, at least by anyone concerned, discussing now the respondents only.

Taking now into consideration the *Manning v. Ketcham* case, which the Government did not cite in respondents' brief, it states that a Judge acting in clear absence of jurisdiction was liable for false imprisonment, which was the result of a contempt proceedings instituted by the Judge for the refusal of a witness to answer a question, and it was held that proceeding in *coram non judice* is permissible if the Judge acts in the clear absence of all jurisdiction and that the Judge's honesty of purpose and sincere belief that he was acting in discharge of his official duty, when he incarcerated the witness for contempt, was not available as a defense. The case is *Manning v. Ketcham*, 58 Federal Reporter, 2d, at page 948.

The Court: 58 Federal Reporter, 2d, at page 948?

Mr. Bender: Yes, your Honor, particularly at page 949, in paragraphs 1, 2 and 3.

The Court: Federal Reporter, 2d.

Mr. Bender: Yes, your Honor.

Now, the question of double jeopardy is really not even before this court, because the only forum [9] that could properly be raised in is the forum where this defendant is being tried for the second time, and that, of course, is the State court. However, the Government has included consideration of the "double jeopardy" aspect in its brief in opposition, and the Government cites to the Court, initially, the *United States v. Lanza*, which is found on page 3 of the brief in opposition. That case holds that where the same act is an offense against both state and federal governments, its prosecution and punishment by the latter after prosecution and punishment by the former, is not double jeopardy.

For the record, your Honor, it appears that your Honor was just served with the respondents' brief, just handed a copy of the respondents' brief in opposition.

The Court: Yes, to the Order.

Mr. Bender: To the Order to Show Cause. Of course, that was filed, completely filed in proper accordance with the Rules of the United States District Court for the Southern District of California, Rule 3(d), which provides that "within five days after service of the notice thereof upon him," meaning the respondents, we may "serve and file a brief, but complete, written statement of all reasons in opposition thereto and an answering memorandum of points and authorities"—

The Government was served in this case on Friday of [10] last week, and yesterday was the fifth day; and, also, of course, the brief was filed timely.

The Court: Well, I worked very hard on this matter all week end.

Mr. Bender: Yes, your Honor. Well, I worked on it also.

The Court: Yes.

Mr. Bender: The Government's statement there was only with reference to the original petition not having been filed within the ten days. Of course, your Honor shortened the time, and properly so, but the Government filed this within the time permitted.

The Lanza case that I am referring to was decided by the Supreme Court of the United States.

The Court: You cite it here in your memorandum.

Mr. Bender: Yes, your Honor. It involved a prior conviction in the state court and imposition of sentence and a subsequent trial in the federal court based upon the same acts.

The Court: Of course, in this Lozoya case you have had an acquittal by this particular Court of this defendant.

Mr. Bender: That is even stronger, because the court in the Lanza case went into some discussion about the situation where the defendant then would serve two sentences based upon the same act. [11]

Now, in this case, the defendant having been acquitted, any equities, and, of course, they would only be moral equities and not legal equities—and I use the word "equities" in a very loose sense—would certainly militate to sustain the charge

against Lozoya, as against Lanza where he was convicted in both forums.

On page 4 of our brief, at line 17:

“The jurisdiction of the federal courts over a prosecution against one charged with the unlawful possession of smoking opium is not exclusive.”

The Court: I have read that.

Mr. Bender: Your Honor, the respondents ask what recourse our agents would have if they were cited for contempt by the State court?

The Court: Well, that isn't the particular problem at this time. That is not before the Court.

Mr. Bender: All right. Surely, your Honor, if it is a bald question of the State of California thinking that it has an action against a person who has violated one of its laws and the same act would be a violation of other law, the State of California should be permitted to litigate this matter with the witnesses and exhibits and as fully and properly as it may be presented before that forum, just as your Honor permitted it to be presented here.

The Court: Of course, you have a right to disagree with [12] the court. You know that. The court disagrees with you. I worked hard on the matter and I have prepared a written order which I am going to file and furnish a copy to each party. When I come back I intend to file a written opinion. So I will file the written order of the court and I will read the pertinent provision here.

Mr. Bender: May I have one more moment to review my facts, your Honor, first?

The Court: Yes, sir.

Mr. Bender: Has your Honor had an opportunity to peruse the brief to the extent of seeing that no constitutional guarantee like the Fifth Amendment——

The Court: Mr. Bender, can't you take the court's word for it that I worked all week end on this particular case?

Mr. Bender: Yes, your Honor, but you were just handed the brief in opposition.

The Court: Yes, but I am a graduate of a law school, you know. I say I worked all week end on this particular case and researched the matter. I spent hours on it.

Mr. Bender: Yes, your Honor.

The Court: And the Court feels very keenly about this case.

Mr. Bender: Your Honor, from the respondents' position it would be a wrongful thing for the court to enjoin the respondents from testifying in other proceedings elsewhere. [13]

The Court: I know you feel that way, but this Court feels on this matter of the order to show cause that when the court has tried this defendant and acquitted the defendant, that should end the matter. The court is going to read its written order at this time, and the court will file an opinion. I am sorry that I disagree with you, but that is the function of the court.

Mr. Bender: Your Honor, the Government was

just hoping to avoid any further controversy concerning the matter. It seems that it could be easily disposed of without any further difficulty, in the State court, without the necessity of any further Federal proceedings, and that it should go over to the State court where it belongs.

The Court: Well, I feel that the defendant having been tried in the Federal court and having been acquitted, that should end the matter. That is the view of the Court.

Mr. Bender: That is contrary to the law of the Supreme Court of the United States.

The Court: All right. I have considered the case. I am going to read the order of the court and the Government can take any position they want from here on, and I am in time going to file a written opinion. I am going to read the pertinent provision of the order, without going into the preamble I have written:

"It Is Hereby Ordered that said Jose [14] Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller are hereby permanently enjoined from testifying concerning the subject of said detection, apprehension, arrest, interrogation and the search and seizure of said nine and one-half pounds of marijuana, and said parties, together with their agents, associates and any parties having the said nine and one-half pounds of marijuana are ordered to forthwith return and deposit the same with the Clerk of this Courtroom, and all persons are restrained from ordering and

compelling the parties enjoined herein from testifying in any proceeding.

“Dated: This 10th day of January, 1957.

“/s/ THURMOND CLARKE,
“United States District
Judge.”

I will file the original and serve each one of you with a copy.

We will take a short recess of four or five minutes before we take up the next case.

[Endorsed]: Filed March 5, 1957. [15]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, John A. Childress, Clerk of the United States District Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled cause:

A. The foregoing pages numbered 1 to 106, inclusive, containing the original

Indictment;

Commissioner's Transcript of Proceedings;

Waiver of Jury;

Trial Memorandum;

Receipt Signed by Joseph F. Bender;

Order to Show Cause;

Petition of Refugio Gonzalez Lozoya;

Marshal's Return of Service on Order to Show Cause;

Brief by Respondents in Opposition to Order to Show Cause;

Order Restraining Federal Officers From Testifying in State Criminal Proceedings;

Minutes of the Court for January 10, 1957;

Receipt for Money, Evidence, or Other Property;

Minutes of the Court for January 11, 1957;

Affidavit of Respondents in Support of Motion to Suspend Order or Injunction Pending Appeal;

Notice of Appeal;

Designation of Record on Appeal (filed January 14, 1957);

Designation of Record on Appeal (filed February 1, 1957);

and a full, true and correct copy of the Minutes of the Court on

June 4, 1956;

June 11, 1956;

July 17, 18, 19, 20, 1956.

B. 4 volumes of reporter's official transcript of proceedings had on

January 10, 1957;

July 18, 17, 19, 20, 1956.

C. Plaintiff's Exhibits 1 and 2 and Defendant's Exhibit B.

I further certify that my fee for preparing the foregoing record, amounting to \$1.60, has not been paid by appellant.

Witness my hand and the seal of said District Court this 6th day of March, 1957.

[Seal]

JOHN A. CHILDRESS,

Clerk;

By /s/ CHARLES E. JONES,

Deputy.

[Endorsed]: No. 15468. United States Court of Appeals for the Ninth Circuit. Jose Ramirez, Meyer Goodman, Michael Gullon, Bill H. Freeman and Robert E. Miller, Appellants, vs. Refugio Gonzalez Lozoya, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed March 8, 1957.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15468—CD

UNITED STATES OF AMERICA,

Plaintiff-Appellant,

vs.

REFUGIO GONZALEZ LOZOYA,

Defendant-Appellee.

JOSE RAMIREZ, MEYER GOODMAN, MI-
CHAEL GULLON, BILL W. FREEMAN and
ROBERT E. MILLER,

Appellants,

vs.

REFUGIO GONZALEZ LOZOYA,

Appellee.

POINTS ON WHICH APPELLANTS
INTEND TO RELY

Comes Now the United States of America, plain-
tiff-appellant herein, and Jose Ramirez, Meyer
Goodman, Michael Gullon, Bill W. Freeman, and
Robert E. Miller, appellants herein, by their at-
torneys, Laughlin E. Waters, United States At-
torney; Louis Lee Abbott, Assistant United States
Attorney, Chief, Criminal Division, and Thomas H.
Ludlow, Jr., Assistant United States Attorney, and

set forth for this Honorable Court the points on which they intend to rely on appeal:

I.

Appellee is not subjected to double jeopardy by threatened prosecution by the State of California, merely because he has been acquitted of a related crime in the Federal courts.

II.

Appellee is not subjected to double jeopardy by threatened prosecution by the State of California, even though acquitted of a related Federal crime, where different offenses are charged and different facts are necessary to a conviction under each statute.

III.

The order appealed from is void as to certain appellants not served with notice of the hearing below.

IV.

The marijuana seized by the narcotics agents from appellee Lozoya, and admitted by the Court below, is legal, competent evidence.

V.

The order appealed from is not supported by the evidence.

VI.

The order appealed from is not supported by, nor responsive to. appellee's petition.

VII.

The Court below deprived appellants of their right to a fair hearing.

VIII.

The allegations of torture in the order appealed from are not supported by the evidence.

IX.

The allegations of the order that appellee was subjected to beating by appellants are not supported in any way by the evidence as to certain appellants.

X.

The alleged beatings administered by the appellants are alleged to have occurred subsequent to the seizure of the marijuana, and have no bearing on the commission of the crime charged.

Respectfully submitted,

LAUGHLIN E. WATERS,
United States Attorney;

LOUIS LEE ABBOTT,
Assistant U. S. Attorney,
Chief, Criminal Division;

/s/ THOMAS H. LUDLOW, JR.,
Assistant U. S. Attorney,
Attorneys for Appellants.

Affidavit of Service by Mail attached.

[Endorsed]: Filed March 20, 1957.

No. 15468

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOSE RAMIREZ, MEYER GOODMAN, MICHAEL GULLON,
BILL H. FREEMAN and ROBERT E. MILLER,
Appellants,

vs.

REFUGIO GONZALEZ LOZOYA,

Appellee.

BRIEF OF APPELLANTS.

LAUGHLIN E. WATERS,
United States Attorney,

LLOYD F. DUNN,
*Assistant U. S. Attorney,
Chief of Criminal Division,*

JOSEPH F. BENDER,
Assistant U. S. Attorney,
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Los Angeles 12, California,
Attorneys for Appellants

FILED

AUG 31 1957

PAUL P. GIBSON, CLERK

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No. 15468

IN THE

United States Court of Appeals
FOR THE NINTH CIRCUIT

JOSE RAMIREZ, MEYER GOODMAN, MICHAEL GULLON,
BILL H. FREEMAN and ROBERT E. MILLER,

Appellants,

vs.

REFUGIO GONZALEZ LOZOYA,

Appellee.

BRIEF OF APPELLANTS.

I.

JURISDICTIONAL STATEMENT.

The District Court has jurisdiction to grant injunctions under Rule 65 of the Federal Rules of Civil Procedure, and this Court has jurisdiction to entertain the appeal and review the permanent injunction under the provisions of Title 28, Sections 1291 and 1294 of the United States Code.

II.

STATEMENT OF THE CASE.

A. Facts.

On May 29, 1956, the Federal Grand Jury for the Southern District of California returned a two count indictment against Refugio Gonzalez Lozoya charging transfer without a written order of approximately nine and one-half pounds of marijuana in count one, as pro-



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II.

STATEMENT OF THE CASE.

A. Facts.

On May 29, 1956, the Federal Grand Jury for the Southern District of California returned a two count indictment against Refugio Gonzalez Lozoya charging transfer without a written order of approximately nine and one-half pounds of marijuana in count one, as pro-

scribed by United States Code, Title 26, Section 4742(a), and acquisition of the marijuana without payment of the federal tax, in count two, in violation of United States Code, Title 26, Section 4744(a).

Lozoya was arraigned June 4, 1956, entered a plea of not guilty on June 11, 1956, and the matter was set for trial July 17, 1956. On July 17, 1956, Lozoya waived his right to trial by jury, the government consented and the Court, the Honorable Thurmond Clarke presiding, approved the waiver. Trial commenced July 17, 1956, continued July 18, 19, and concluded on July 20, 1956. The five appellants, Federal Narcotic Agents, each testified as witnesses for the government to their observation of the sale and transfer by Lozoya of a gunny sack, which contained marijuana, from the trunk of his automobile into the trunk of the government vehicle of then undisclosed narcotic agent Ramirez, in the daylight, at the Beverly Ranch Market in Montebello, California, on May 17, 1956.

Lozoya testified that he did not remove the sack from his trunk or place it in the government vehicle and that no one else opened or took anything from his trunk or placed anything in the government trunk in his presence before his arrest at the market. Mrs. Macias testified as a witness for the defense, that she was doing her dishes and would look out of the window on occasions [Tr. of Rec. p. 443] and did not see the trunk of Lozoya's car lifted up at any time and that she saw no one carry a bag from the trunk of one car to the other [Tr. of Rec. p. 424].

The government argued in part that "Agent Ramirez testified unequivocally to the transfer of this bag by the defendant from his car to the government car. Agent

Goodman observed it, Agent Gullon observed it, and Agent Freeman observed the lid of the trunk go up, before Agent Freeman started his route through the market to take up his position for the arrest . . .” and “The defendant having transported and transferred this marijuana into the government car is guilty as charged” [Tr. of Rec. pp. 453-454].

The Court stated:

“Mr. Marcus, you don’t need to comment, because the Court has made up its mind. I feel, in view of the denial by the defendant and no further proof, the defendant is entitled to the benefit of the presumption. The Court will find the defendant not guilty on both counts.” [Tr. of Rec. p. 454.]

On cross-examination Agent Gullon testified that after the arrest Lozoya was taken to the interrogation room of the Bureau. Agent Gullon was the only agent in the room with Lozoya. Gullon attempted to take the fingerprints of Lozoya who resisted and pushed Gullon [Tr. of Rec. p. 359] and they exchanged blows [Tr. of Rec. p. 364]. Gullon struck Lozoya two or three times with his fist [Tr. of Rec. p. 355], subdued him and handcuffed him to the chair in the interrogation room [Tr. of Rec. p. 359]. At the time Gullon fought with Lozoya no one else came into the room [Tr. of Rec. p. 363. Agent Freeman testified that Agent Gullon told Freeman he had to strike Lozoya [Tr. of Rec. p. 391]. Lozoya testified that Gullon never asked to take fingerprints [Tr. of Rec. p. 426], that he did not push Gullon [Tr. of Rec. p. 427] that without any conversation Gullon started slapping Lozoya around right away and said that if Lozoya did not tell where he had obtained the marijuana, he, Agent Gullon, was going to kill Lozoya [Tr. of Rec. p. 409].

Lozoya also testified he was knocked down and that two officers struck him in succession [Tr. of Rec. p. 410]. Lozoya testified that after Gullon ceased that Agent Miller came in and without asking any questions, just walked around a little and surveyed Lozoya for a while and then started striking him, knocked him down and kicked him [Tr. of Rec. p. 410]. Agent Miller denied that he ever struck Lozoya [Tr. of Rec. p. 451].

Subsequent to acquittal, and on Friday, January 4, 1957, Lozoya filed a petition in the originally captioned criminal proceedings [Tr. of Rec. p. 25, *et seq.*] which recites that on August 10, 1956, the State of California charged Lozoya with illegal possession of contraband marijuana in violation of Section 11500 of the Health and Safety Code of the State of California and that the preliminary hearing was set for Friday, January 11, 1957, in the Municipal Court. The petition recited that the second pending prosecution caused Lozoya "to be twice placed in jeopardy for the same identical and necessarily included offense in the Federal and State Courts" [Tr. of Rec. p. 33].

Petitioner contended that the actions of appellants caused petitioner "to be deprived of due process of law in violation of the Fifth and Fourteenth Amendments" [Tr. of Rec. p. 32].

Petitioner sought an order enjoining appellants from testifying in the Municipal Court proceedings or any other proceedings founded upon the same charge, and an

order directing appellants to return the contraband marijuana to the Clerk of the Federal Court.

The Honorable Thurmond Clarke issued an Order to Show Cause why said petition should not be granted, set the matter for hearing Thursday morning, January 10, 1957, and shortened time for service on appellants to Tuesday, January 8, 1957 [Tr. of Rec. pp. 24-25].

The Order to Show Cause was served personally on appellants Ramirez, Goodman and Freeman on January 7, 1957, prior to the date set for hearing. It was not served on appellants Gullon and Miller [Tr. of Rec. pp. 48-50].

On Wednesday, January 9, 1957, the second day after service on some appellants and one day before the hearing, the United States Attorney filed a brief in opposition to said Order to Show Cause, on behalf of appellants [Tr. of Rec. p. 36, *et seq.*].

At the hearing on January 10, 1957, no evidence was offered or received.

The Court stated it had worked very hard on the matter all week-end [Tr. of Rec. pp. 462 and 464], meaning the week-end of January 5 and 6, 1957.

The Court stated it had prepared a written order and intended to file a written opinion [Tr. of Rec. p. 463].

The Court did not read or consider appellant's brief prior to preparation of the written injunction order or hearing and received the brief in opposition during the oral argument to the Court by counsel for appellants at

the hearing on January 10, 1957. The brief was timely filed in compliance with local rule 3(d) [see Tr. of Rec. pp. 461 and 464].

The Court stated the basis for its injunction to be that:

“This Court feels on this matter of the Order to Show Cause that when the Court has tried this defendant and acquitted the defendant, that should end the matter.” [Tr. of Rec. p. 465.]

The Court iterated its position, stating:

“Well, I feel that the defendant having been tried in the Federal Court and having been acquitted, that should end the matter. That is the view of the Court.” [Tr. of Rec. p. 465.]

The Court then read a portion of its order enjoining appellants. The written order recited that Lozoya was deprived of due process of law and of the American tradition of fair play that included beatings and torture by Agents Ramirez, Goodman, Gullon, Freeman and Miller. It permanently enjoined appellants and each of them, from testifying anywhere concerning the matter; purportedly enjoined all persons including the State Court of California from ordering and compelling the agents to testify; and ordered the marijuana returned to the Clerk of the Federal Court [Tr. of Rec. pp. 44-45; Cf. pp. 465-466].

From the aforesaid permanent injunction, appellants appeal.

B. Questions Involved.

This appeal raises the question of whether or not a Federal District Court after acquittal of defendant, may enjoin the witnesses who are Federal Narcotic Agents, from testifying and enjoin the State Court from compelling the agents to testify in a prospective State prosecution of defendant for an offense against the State law arising out of the same factual circumstances for which defendant was tried in the Federal Court, where no evidence was obtained unlawfully by the agents and no motion to suppress evidence on any purported basis was ever made in the Federal Court before or during trial or before defendant was acquitted.

Germane to this issue are contentions by the appellants that double jeopardy does not arise when defendant is to be tried a second time for a different offense; that defendant is not in second or double jeopardy until actually brought to trial for the second time; that former jeopardy is a defense which may only be asserted at the second prosecution; that the defense, former jeopardy, can only be presented in the State forum where defendant is to be tried and cannot be raised initially in the Federal District Court where defendant was first in jeopardy, but only once in jeopardy; that the supervisory powers of the Federal Court over Federal Agents, as in the *Rea* case, have no application where defendant never contended that it was his marijuana or that it was obtained by unlawful search and seizure or that a confession or any admission was obtained by the purported beating; that after Federal ac-

quittal and proper withdrawal of the marijuana from evidence the District Court had no authority to order the marijuana back into custody of the clerk; that the injunction is void as to appellants Gullon and Miller who were not served with notice of the injunction hearing below; that the Court below deprived all five appellants of their right to a fair hearing by preparation of the written injunction order before the hearing, before receipt of the appellants' brief in opposition which was timely filed, and without the taking of any evidence at said hearing; that the Court below made a finding of beatings and torture by appellants although Lozoya's petition did not refer to alleged beatings and torture by inference or at all; that there was no evidence offered at said hearing of purported beating or torture; that there was not one scintilla of evidence during the trial or at all that three of the appellants, Agents Ramirez, Goodman or Freeman participated in any alleged beating or torture of Lozoya or were even present during any such alleged misconduct; that the incident in which Lozoya refused to be fingerprinted, with the ensuing scuffle and striking of Lozoya, occurred after the sale and delivery of the marijuana and just before he was booked in the County Jail so that no testimony of events which occurred before the scuffle should be enjoined on any theory; that no one tortured Lozoya for any purpose and no evidence was alleged to have been obtained as a result of beatings or torture.

III.

SPECIFICATION OF ERRORS.

1. Appellee is not subjected to double jeopardy by threatened prosecution by the State of California, merely because he has been acquitted of a related crime in the Federal courts.

2. Appellee is not subjected to double jeopardy by threatened prosecution by the State of California, even though acquitted of a related Federal crime, where different offenses are charged and different facts are necessary to a conviction under each statute.

3. The order appealed from is void as to certain appellants not served with notice of the hearing below.

4. The marijuana seized by the narcotics agents from appellee Lozoya, and admitted by the Court below, is legal, competent evidence.

5. The order appealed from is not supported by the evidence.

6. The order appealed from is not supported by, nor responsive to, appellee's petition.

7. The Court below deprived appellants of their right to a fair hearing.

8. The allegations of torture in the order appealed from are not supported by the evidence.

9. The allegations of the order that appellee was subjected to beating by appellants are not supported in any way by the evidence as to certain appellants.

10. The alleged beatings administered by the appellants are alleged to have occurred subsequent to the seizure of the marijuana, and have no bearing on the commission of the crime charged.

IV.
ARGUMENT.

The District Court abused its discretion in issuing the injunction since there in fact occurred no deprivation of any constitutional right of Lozoya and no violation of any federal law or rule pertaining to searches, seizures, or process. The acquittal in federal court created in Lozoya no immunity to prosecution by the State for violation of its laws. The State Court not the Federal District Court should decide whether the State law has been violated and whether Lozoya may be tried and convicted there. The Federal acquittal gives rise to no right or equity to permit the issuance of an order restraining the appellants from testifying in the State prosecution and no right for the Federal District Court to enjoin the State Court from subpoenaing and compelling the federal agents to testify in the state proceedings.

Glaring anomalies are present between the evidence aduced during the federal trial of Lozoya, the petition of Lozoya to enjoin appellants, the hearing, and the injunction.

The petition asserted the double jeopardy of Lozoya. The trial court stated at the hearing that it was issuing the injunction because the federal trial and acquittal should end the matter. Yet the prepared written injunction did not allude to double or former jeopardy.

On the other hand, the petition did not mention an alleged beating or torture of Lozoya, but the injunction recited that Lozoya was beaten and tortured by appellants.

As for the marijuana, Lozoya never claimed it to be his and never made a motion to suppress it on the ground

of unlawful search and seizure, as done in the *Rea* case, or on any other ground. In fact, the court admitted the marijuana into evidence at the trial. Other than being deemed in the custody of the court to resist an action by the defendant to replevy the contraband, the court had no right of control of the marijuana subsequent to acquittal of Lozoya and withdrawal of the evidence from the custody of the clerk in accordance with federal local court rules concerning withdrawal of evidence after trial. Only the Secretary of the Treasury may destroy or order destruction of the marijuana which he presently may not do while the bag of marijuana gathers dust in the vault of the clerk of the court.

Another anomaly appears in that the petition did not pray that the Federal District Court enjoin the State Court, yet the injunction purports to do so. Without notice or hearing, without any showing of knowledge of the hearing or representation by counsel, the Honorable Thurmond Clarke enjoined all persons including the State Court Judge or Judges from ordering and compelling the appellants to testify as witnesses in the anticipated State prosecution of Lozoya. In this regard, during the hearing the Court below stated that the problem of appellants being cited for contempt by the State Court was not before the Federal Court [Tr. of Rec. p. 463].

The Supreme Court of the United States has indicated that the Federal Court should not restrain the State Court in relitigation cases, *Toucey v. New York Life Ins. Co.*, 314 U. S. 118. Although *Toucey* is a civil case, the parallel with Lozoya is apparent. Although involving a State prosecution and State officer only, *Stefanelli v. Minard*, 342 U. S. 117, is of interest. There, the appellate court held that the District Court had correctly refused to en-

join State officers from prosecuting the defendant with the aid of illegally obtained evidence. The court stated: "The consequences of exercising the equitable power here invoked are not the concern of a merely doctrinaire alertness to protect the proper sphere of the States in enforcing their criminal law. If we were to sanction this intervention, we would expose every State criminal prosecution to insupportable disruption. Every question of procedural due process of law—with its far-flung and undefined range—would invite a flanking movement against the system of State courts by resort to the federal forum, with review if need be to this Court, to determine the issued. Asserted unconstitutionality in the impaneling and selection of the grand and petit juries, in the failure to appoint counsel, in the admission of a confession, in the creation of an unfair trial atmosphere, in the misconduct of the trial court—all would provide ready opportunities, which conscientious counsel might be bound to employ, to subvert the orderly, effective prosecution of local crime in local courts. To suggest these difficulties is to recognize their solution. (342 U. S. at 123-124.)

A major basis of the decision in *Stefanelli* was the consideration that the discretion in question involved the intrusion of the federal courts into the administration of State criminal law. In *Rea*, as in the instant matter, federal officers were involved and therefore the matter went beyond the administration of State criminal law, but, as subsequently pointed out in greater particularity, *Rea* involved illegally seized evidence, an essential element not present here.

It further appears that no evidence was received at the hearing in *re* Order to Show Cause and there is

no evidence to support the injunction. If the testimony from the prior federal trial of Lozoya was amenable to being placed before the federal court for its consideration at the hearing, by motion therefore, no such motion was made. Accordingly, there was no evidence at all before the court at the hearing concerning alleged beating or torture of Lozoya.

If the evidence elicited at the prior trial had been properly before the court at the hearing the trial court nevertheless should have afforded appellants a fair and impartial hearing, by reading and considering the authorities cited by appellants in their brief in opposition, before preparation by the court of the written injunction or at least before issuance of the injunction.

There was simply no evidence anywhere and no contention by anyone, prior to the finding in the permanent injunction, to the effect that appellants Ramirez, Goodman or Freeman were participants or were in any manner involved in the alleged beating of Lozoya. Will the beacon of Appellate justice permit the gratuitous branding by the trial court of these three appellants as beaters and torturers of Lozoya to forever blight their reputation and sully their record. The Appellate Court should not countenance this departure from the requirement that an injunction be supported by evidence.

Agent Ramirez was the chief government witness so apropos of the statement of the court that it believed the matter should end without trial of Lozoya by the State, the trial court had to enjoin Ramirez to prevent prosecution by the State which otherwise could have proceeded with or without the appearance of appellants Gullon and Miller as witnesses.

Appellant Gullon testified that Lozoya resisted the attempt to take his fingerprints, a scuffle ensued and Gullon struck Lozoya two or three times. It may be asserted by appellants that Lozoya had no right to refuse to submit to the taking of his fingerprints and that reasonable force was permissible to effectuate the taking of the prints, or it could be contended that the resistance by Lozoya was interpreted by appellant Gullon as the incipient intention of Lozoya to escape, which intention Gullon throttled and then handcuffed Lozoya to a chair. But it is not necessary to inquire into these possibilities to justify acquisition of evidence because no evidence was obtained as a result of the scuffle. No allegation has been made and no evidence was introduced at any time to show that Lozoya was physically or otherwise mistreated into confessing or admitting anything.

Lozoya has not pointed to any specific federal right of which he might be deprived if local prosecution continues, with the testimony of the federal agents and use of the marijuana.

This court is of course conversant with *Rea v. United States*, 350 U. S. 214, wherein the Supreme Court held that where a federal agent has violated the federal rules governing searches and seizures, the District Court should enforce the rules by enjoining the agent from using the fruits of his unlawful act, in State as well as Federal proceedings. In the *Rea* case the evidence was seized under an improperly issued search warrant so that the evidence was unlawfully obtained. But the differences between the facts in the *Rea* case and in the instant Lozoya matter make the *Rea* case almost wholly inapposite. In the *Rea* case the evidence was seized in violation of Rule 41(b) of the Rules of Criminal Procedure

and the District Court in the initial federal proceeding granted the motion to suppress the evidence and the indictment was dismissed. In Lozoya no allegation of unlawful search or seizure or arrest was ever made and no motion was ever made to suppress the evidence. Although the marijuana was admitted into evidence, Lozoya has at all times claimed that the narcotic was not his and that he knew nothing whatsoever about it. Further, Lozoya made no claim of any impropriety on the part of any federal agent until the State prosecution was instituted. Then the only claim was that the second prosecution violated the Fifth and Fourteenth Amendment rights of Lozoya because, having been acquitted in federal court, Lozoya should not be prosecuted in State court.

In this regard, one act may constitute an offense against two sovereignties for which each may prosecute. (*United States v. Ah Hung*, 243 Fed. 762.) Existing federal law does not require that the two sovereignties prosecute different offenses arising out of the same acts. (*United States v. Lanza*, 260 U. S. 377, 383, 385.) However, if the law were to require different offenses the requirement is met as each sovereign here has charged a different offense. In the federal case, unlawful acquisition without payment of the tax, and transfer without a written order, of marijuana, was charged whereas the State charged unlawful possession of marijuana. Accordingly, even if the two sovereignties rule were not extant, no element of double jeopardy would be present here.

The rationale of the *Rea* case was not based upon double jeopardy; there was no possible double jeopardy in the *Rea* case as defendant there was never in jeopardy in the federal proceedings. The evidence was suppressed

by the Federal Court and defendant was never brought to federal trial hence never placed in jeopardy.

In the Lozoya case, Lozoya was placed in jeopardy in the federal proceedings. A second and subsequent prosecution of Lozoya by the same federal sovereignty for the same offenses would have placed Lozoya in double jeopardy and the defense, former jeopardy would have been properly raised under these hypothetical circumstances. But Lozoya was not prosecuted a second time by the same sovereign; he was not prosecuted for the same offense and his prosecution by the State had not yet placed him in jeopardy there, so that if the defense of former jeopardy were to be asserted in the State court it would be premature. See *In re Rufugio Gonzalez Lozoya*, on Habeas Corpus, 146 Cal. App. 2d 702, decided December 10, 1956, by the District Court of Appeal of the State of California which holds that the Appellate Court will not try any of the defenses in advance which may be available to petitioner should he be brought to trial; that all of his defenses must be presented in the proper manner at the proper time and that the fact, if it be a fact, that the defense of once in jeopardy is available to petitioner does not afford any grounds for petitioner's release on habeas corpus, citing *In re Collins*, 151 Cal. 340, 350.

The defense, former jeopardy, was erroneously asserted by Lozoya in the federal forum where no second, prosecution was ever pending. Surely the court, whether state or federal, wherein an alleged prosecution is pending is the only court where the defense of former jeopardy may be asserted and then it may be properly considered when defendant has actually been placed in second jeopardy by commencing trial.

If for the purposes of argument only it be assumed that the incredible testimony of Lozoya is true and that appellants Gullon and Miller, as testified to by Lozoya, beat him in succession without asking any questions [Tr. of Rec. p. 410], and that these appellants, or one of them, beat Lozoya to elicit a confession from him and not to prevent his possible escape or to force him to submit to the taking of his fingerprints, this would have been grievous reprehensible conduct not countenanced by this court or counsel. It would have resulted in a civil rights prosecution of the person or persons who beat Lozoya but it would still not provide the basis for the Federal Court to enjoin the agent or agents from testifying in Federal as well as State Court. If not, why was there no attempt by Lozoya's able and competent counsel before or at least during the federal trial to prevent the receipt of or to strike the testimony of said agents, appellants Gullon and Miller. Further, if an involuntary confession or any admission had been obtained, in this hypothetical situation given, neither a confession nor an admission would be competent evidence. With our feet back on the ground, the Lozoya transcript of record shows no confession or admission was elicited from Lozoya responsive to the alleged beating. Surely, whether or not on appeal this court believes that one or that two appellants did or did not wrongfully beat Lozoya is not the issue before the court because no evidence was allegedly obtained thereby. On analogy, if a man criminally assaulted a child and upon being apprehended was beaten by one of the arresting officers who had become incensed at the enormity of the man's crime, no court should acquit the man of the assault on the child or enjoin testimony of the assault on the child merely because

of the unwarranted beating by the officer. To do so would encourage criminals to commit the most heinous crimes and if apprehended, to provoke a personal attack upon themselves by the arresting or other officer to thereby avoid prosecution.

The position of the District Court, through the eyes of appellants may be stated briefly. The court below did not desire to permit Lozoya to be tried in the State Court for an offense arising out of acts by Lozoya for which he had been previously acquitted by the Federal Court. In effectuating this desire, the trial court abused its discretion by issuing an injunction which is vulnerable in many ways and is simply not supported by the evidence.

1. Appellee Is Not Subjected to Double Jeopardy by Threatened Prosecution by the State of California, Merely Because He Has Been Acquitted of a Related Crime in the Federal Courts.

One act may constitute an offense against two sovereignties for which each may prosecute.

Marteney v. United States, 218 F. 2d 258, cert. den. 348 U. S. 953;

United States v. Lanza, 260 U. S. 377, 382, 385;

United States v. McCain, 1 F. 2d 985.

The jurisdiction of the Federal Courts over a prosecution against one charged with unlawful possession of smoking opium is not exclusive. (*United States v. Ah Hung*, 243 Fed. 762.)

In the Lozoya case, the sale and transfer by Lozoya of approximately nine and one-half pounds of marijuana in the gunny sack which Lozoya removed from the trunk of his automobile and placed in the trunk of the govern-

ment vehicle of undisclosed federal narcotic agent Ramirez, one of the appellants herein, in the presence of the other appellants, was one act by Lozoya which is amenable to prosecution by both sovereigns; by the State of California, for violation of its laws proscribing illegal possession of marijuana, and by the federal government, for unlawful acquisition, without payment of the tax, and transfer of marijuana, without a written order.

One is not in jeopardy until the jury has been impaneled and sworn, and where the case is tried to the court without a jury, jeopardy begins after the court has begun to hear evidence.

McCarthy v. Zerbst, 85 F. 2d 640, 642.

“Jeopardy” attaches, within the provisions of the Fifth Amendment to the United States Constitution which provides that no person shall be subject for the same offense to be twice put in jeopardy of life or limb, when the accused has been subjected to a charge and the court has begun to hear evidence.

Clawans v. Rives, 104 F. 2d 240, 242.

On a plea of double jeopardy, defendant has the burden of proof.

Kastel v. United States, 23 F. 2d 156.

In the *Lozoya* case, Lozoya did not show that he was in double jeopardy. The State Preliminary Hearing was set for January 11, 1957, which was to occur subsequent to the federal injunction issued by the Honorable Thurmond Clarke on January 10, 1957. *A fortiori*, as the State Preliminary Hearing was prospective, the trial in the State Court had not commenced, no jury was im-

paneled or, if waived, no evidence was heard by the State Court, so Lozoya has never been in double jeopardy.

The defense, double or former jeopardy, would have been premature if asserted by Lozoya in the very State Court which contemplated trial of Lozoya. The proceedings in that court had not reached the stage of placing Lozoya in jeopardy.

It follows, as the night the day, that if the defense of double jeopardy could not have been asserted in the State forum, because Lozoya was not yet in jeopardy there, then the defense could not be asserted in the Federal Court where Lozoya has been tried once but where no other prosecution was pending.

A threatened second prosecution even before the same court does not constitute a placing in jeopardy. The injunction of appellants was based upon the District Court's erroneous belief that the trial of Lozoya in Federal Court permitted that Federal Court to enjoin appellants to avoid double jeopardy and end the matter [Tr. of Rec. pp. 464-465]. The injunction should be dissolved.

2. Appellee Is Not Subjected to Double Jeopardy by Threatened Prosecution by the State of California, Even Though Acquitted of a Related Federal Crime, Where Different Offenses Are Charged and Different Facts Are Necessary to a Conviction Under Each Statute.

Where two offenses are charged having relation to the same matter or transaction there is no double jeopardy if each offense requires proof of a fact which the other does not require.

Matthews v. Swope (C. C. A. 9th), 111 F. 2d 697, 699.

The test is not whether the defendant has already been tried for the same act, but whether he has been put in jeopardy for the same offense.

Gavieres v. United States, 220 U. S. 338, 342;

Poffenbarger v. United States, 20 F. 2d 42, 45;

United States v. Brimsdon, 23 F. Supp. 510, 512.

In *Lozoya*, the federal government was required to prove transfer by Lozoya of marijuana without a written order from the Secretary of the Treasury, in Count One, and acquisition of marijuana by Lozoya without payment of the tax, in Count Two. The State of California need prove only possession of marijuana by Lozoya.

The three offenses, the federal offenses of transfer and acquisition and the State offense, possession of marijuana, are separate offenses so that placing Lozoya in jeopardy for the two former federal offenses does not constitute former jeopardy with respect to the latter stated offense of possession which constitutes a violation of law of a different sovereign.

3. The Order Appealed From Is Void as to Certain Appellants Not Served With Notice of Hearing Below.

An injunction will not be heard without reasonable notice to the opposite party or his attorney.

State of New York v. State of Connecticut, 4 U. S. 1.

See also:

Gregory v. Pike, 79 Fed. 520.

Appellants Gullon and Miller were never served with Notice of Hearing *in re* the Order to Show Cause. The

United States Attorney filed a brief in opposition dated January 9, 1957 in which the United States Attorney purported to represent all five appellants. If there had been prior representation of appellants Gullon and Miller by the United States Attorney the brief would have indicated constructive knowledge of the hearing by counsel for these two appellants and have sufficed as sufficient constructive notice to them of the pending hearing. As these appellants have filed no independent pleadings, the Circuit Court may assume that these appellants have acquiesced in their representation by the United States Attorney and ratified the appearance in their behalf at said hearing.

4. The Marijuana Seized by the Narcotics Agents From Appellee Lozoya and Admitted by the Court Below Is Legal Competent Evidence.

If the District Court is found to have abused its discretion in issuing the injunction against the agents, *a fortiori*, that portion of the injunction concerning the marijuana evidence would be set aside. But in any event, this part of the order in itself represents an abuse of judicial discretion, being without any authority or basis.

No one, including Lozoya, has ever claimed the marijuana was obtained by unlawful search or seizure as in the *Rea* case, or by beatings or torture. Accordingly, the portion of the injunction was improper which ordered the evidence returned to the Clerk of the court after having been properly withdrawn from evidence pursuant to the local court rules.

In this regard, the *Rea* case held:

“all property taken or detained under any revenue law of the United States shall not be repleviable,

but shall be deemed to be in the custody of the law and subject only to the orders and decree of the courts of the United States having jurisdiction thereof.”

The apparent purpose of the statute is to provide against the return of contraband to the defendant, but it does not establish any rule concerning its disposition. Further, Lozoya never attempted to replevy the marijuana.

The statutes do not contemplate that the judiciary should be the final depository or disposing agency for contraband such as the marijuana in question here. In fact, it is specifically provided for in 26 U. S. C. 4745 (I. R. C. 1954) that marijuana seized or coming into possession of the United States, where the owners are unknown, shall be confiscated and forfeited to the United States (par. (b)), and the Secretary of the Treasury is authorized to destroy any such marijuana or to deliver it to any department or agency of the United States (par. (c)). From this statute it is apparent that Congress intended that the executive branch, specifically the Treasury Department, should have the authority to dispose of illegal marijuana. Since in this particular matter the owner or owners of the marijuana in question are technically unknown (at least no court has yet found any person responsible for it), the Treasury Department would seem to be the only body authorized to take possession of it.

The defendant would be subjected to no injustices were he to be prosecuted in State Court and he would not be the victim of any illegal acts thereby. In fact, in attempting to have him prosecuted in State Court the

Bureau of Narcotics is carrying out the express mandate of the Congress, as set forth in 21 U. S. C. 198. This statute provides, among other things,

“The Secretary of the Treasury shall cooperate with the several States in the suppression of the abuse of narcotic drugs in their respective jurisdictions, and to that end he is authorized . . . to arrange for the exchange of information concerning the use and abuse of narcotic drugs in said States and for cooperation in the institution and prosecution of cases in the courts of the United States and before the licensing boards and courts of the several States. . . .”

In carrying out this policy of cooperation with the State authorities in the enforcement of narcotics laws, it is of course unnecessary for the Treasury Department permanently to transfer contraband to the State authorities. In fact, contraband used as evidence in State proceedings is in effect merely loaned to the State authorities for the purpose of the particular case. Upon completion of the proceedings, the evidence is returned to the Narcotics Bureau for routine disposition pursuant to the statutes and Treasury regulations.

The first paragraph of Rule 20(a), Local Rules of the United States District Court for the Southern District of California provides for return of exhibits as follows:

“ . . . all . . . exhibits, . . . filed in any cause, shall, . . . be returned to the party or person to whom they belong,”

Subsequent to acquittal of Lozoya it was normal and proper for the government to withdraw the marijuana from evidence pursuant to local rule 20(a) but the Dis-

strict Court, subsequently exceeded its authority when it ordered the return of the marijuana to the Clerk of the Court. Of course, the Bureau complied with the order and returned the approximately 9½ pounds of marijuana to the clerk on January 11, 1957 [Tr. of Rec. pp. 46-47].

The order of the trial court with respect to the evidence should be vacated and the evidence ordered returned to the Secretary of the Treasury or his representative for any use provided by law including an offer into evidence in any state proceeding.

5. The Order Appealed From Is Not Supported by the Evidence.

The burden is upon the person contending double jeopardy to make out his case.

Kastel v. United States, supra.

Lozoya did not show at the hearing or elsewhere that he was then in double jeopardy. He having failed in this regard, the injunction should be dissolved. Concerning when a defendant is in second or double jeopardy this subject was discussed in paragraph IV, subparagraph 1, *supra*.

If alleged beatings and torture are the predicate for the injunction, the evidence at the hearing and, if before the court at the hearing, the evidence from the trial utterly fails to support any finding that appellants Ramirez, Goodman or Freeman were present at or took part in any alleged beating or torture of Lozoya. Therefore, the injunction should be dissolved as to said appellants. It should also be dissolved, as to appellant Miller who did not strike Lozoya, and dissolved as to appellant Gullon who struck Lozoya during an unsuccessful attempt to obtain Lozoya's fingerprints.

**6. The Order Appealed From Is Not Supported by,
nor Responsive to Appellee's Petition.**

The petition of Lozoya asserts an alleged deprivation of due process of law in violation of the Fifth and Fourteenth Amendments [Tr. of Rec. p. 32, par. XVI] and that by the arrest of Lozoya he has been twice placed in jeopardy [Tr. of Rec. p. 33, par. XVIII] as being the basis for issuance of the injunction prayed for. The injunction is apparently purportedly based upon a finding of beatings and torture and is not responsive to the petition which is strangely devoid of any reference to alleged beating or torture of Lozoya.

An injunction will not issue against a person not within or subject to the jurisdiction of court.

Clarke v. Boysen, 39 F. 2d 800, Cert. den. 282,
U. S. 869.

An injunction will not be heard without reasonable notice of the hearing to the party enjoined.

State of New York v. State of Connecticut, 4
U. S. 1.

The injunction provided in conclusion, “. . . and all persons are restrained from ordering and compelling the parties enjoined herein from testifying in any proceedings.”

In effect and fact, the injunction purports to enjoin the State Court and Judges thereof from compelling by subpoena the attendance of appellants as witnesses at the State trial of Lozoya.

As the State Court was not subject to the jurisdiction of the District Court and was not served with Notice of the Hearing or represented there by counsel, that portion of

the injunction which purports to restrain the State Court should be dissolved. Compare *Toucey v. New York Life Ins. Co.*, 314 U. S. 118, discussed *supra*, which reveals the repugnance with which the Supreme Court viewed the injunction issued by a Federal District Court enjoining a proceeding *in personam* in a State Court on the ground, as found by the District Court, that their civil claim in controversy had been previously adjudicated by the Federal Court. The Supreme Court reversed the District Court stating that in general the writ of injunction should not be granted by any court of the United States to stay a proceeding in any court of a State—to prevent needless friction between State and Federal Courts.

In the Lozoya case as elsewhere, the California State Courts are surely capable of determining accurately and fairly the questions arising there in a trial of Lozoya including the defense of former or double jeopardy when and if asserted there by Lozoya at the appropriate time.

7. The Court Below Deprived Appellants of Their Right to a Fair Hearing.

The Petition was filed and the Order to Show Cause issued on Friday, January 4, 1957. The hearing thereon was set for the following Thursday, January 10, 1957.

On January 9, 1957, appellants filed their Brief in Opposition and Points and Authorities, within the period of time provided by Rule 3 (d), of Rules of the United States District Court for the Southern District of California.

When the Court took the bench for the hearing January 10, 1957, it stated during the hearing that it had spent

the weekend, meaning January 4, 5 and 6, 1957, researching the law, and had prepared a written order.

The Court had not seen or read appellant's Brief or Points and Authorities in Opposition prior to the hearing.

During the argument by counsel for appellants the court was handed the Brief in Opposition [Tr. of Rec. p. 461] and did not read the Brief nor permit counsel for appellants to fully argue the matters contained in the Brief. The colloquy was as follows:

"Mr. Bender: Has your Honor had an opportunity to peruse the brief to the extent of seeing that no constitutional guarantee like the Fifth Amendment—

The Court: Mr. Bender, can't you take the Court's word for it that I worked all weekend on this particular case?

Mr. Bender: Yes, your Honor, but you were just handed the brief in opposition.

The Court: Yes, but I am a graduate of a law school, you know. I say I worked all weekend on this particular case and researched the matter. I spent hours on it.

Mr. Bender: Yes, your Honor."

The Court below commenced the hearing in the morning at 10:00 A. M., on January 10, 1957 and should have recessed the hearing long enough to read and consider the timely filed brief and points and authorities in opposition by appellants, before concluding the hearing and giving its decision. Pages 455 to 466, inclusive, of the Transcript of Record, concern the hearing of January 10, 1957.

8 The Allegations of Torture in the Order Appealed From Are Not Supported by the Evidence.

“Torture” specifically means: the act of inflicting severe pain under the orders of a court of justice, royal commission, ecclesiastical organization, or other legal or self-constituted judge or authority, especially as a supposed means of extorting the truth from an accused person; the pain so inflicted; torment by means of the rack or other contrivances for inflicting physical pain, employed for the purpose of extorting confessions; the act of inflicting severe pain as a means of persuasion; the infliction of severe bodily pain either as a punishment or for the purpose of revenge or for the purpose of compelling the person tortured to give evidence or make confessions in judicial proceedings; the act or process of inflicting severe pain, especially, as a punishment, in order to extort a confession, or in revenge; specifically, the act of inflicting such pain under judicial or other authoritative order, as by water or fire, by the boot or thumbscrew, by the rack or wheel, and so forth.

Townsend v. People, 111 P. 2d 236, 239.

The injunction recites that appellants tortured Lozoya. There is no evidence of torture of Lozoya. If the evidence taken during the trial of Lozoya were properly before the court in its consideration of the injunction, and taken in a light most favorable to Lozoya, it does not show that appellants Ramirez, Goodman or Freeman ever struck Lozoya or were present when the altercation occurred. The possible identification of appellant Miller as being the person whom Lozoya described beat Lozoya is tenuous and uncertain. Appellant Miller himself testified as a government witness for the first time on rebuttal. Lozoya never pointed to the individual, Miller, and identified him

as being the person whom Lozoya described allegedly beat and kicked Lozoya. Assuming for argument only that appellant Miller did the things ascribed to him by Lozoya, and conceding that appellant Gullon struck Lozoya two or three times, the evidence nevertheless fails to disclose that this amounted to torture.

Parenthetically, recall for the moment that the sale and transfer of a gunny sack full of marijuana by Lozoya to one treasury agent occurred in the daylight in the presence and under the scrutiny of four other agents. Appellants, at the time of the alleged torture of Lozoya not only did not torture him but had no reason to torture him in the hope he would confess that which they had just observed take place. Even in retrospect, after acquittal of Lozoya by the Federal Court apparently for lack of evidence to overcome the presumption of innocence [Tr. of Rec. p. 454], it does not follow that appellants tortured Lozoya in the belief that a confession by Lozoya would have over-balanced the presumption of innocence where the testimony of five percipient witnesses to the offense failed. Further, it may be assumed that all treasury agents including appellants then knew that an involuntary confession is not admissible into evidence. Appellants had what they must have considered to have been a "cold" case against Lozoya. They had every reason to do nothing to endanger the case by the beating or torture of Lozoya.

At the same time, Agent Gullon had a duty to perform. He was to take the fingerprints of Lozoya. When it appeared the resistance of Lozoya might materialize into a possible escape, it was also the duty of Gullon to immediately discourage this aggressive attitude forming in the mind of Lozoya while in the interrogation room. The decision of appellant Gullon, right or wrong, should

not be judged as having occurred in the calm aura of the judicial chambers but in the light of the circumstances then reasonably apparent to Gullon who was alone with a defendant who had just unlawfully sold an enormous quantity of narcotics and who having refused by physical force to submit to the taking of his fingerprints could have diverted his energies toward escape unless subjugated to the will of the agent and handcuffed to the chair as Agent Gullon proceeded to do.

9. The Allegations of the Order That Appellee Was Subjected to Beating by Appellants Are Not Supported in Any Way by the Evidence as to Certain Appellants.

If it be assumed that the testimony from the trial was properly before the court in its consideration of the injunction, there was no evidence that appellants Ramirez, Goodman or Freeman were present during the altercation in the federal building in which Lozoya alleges he was beaten by appellants Gullon and Miller. Accordingly, the injunction as to these appellants must be dissolved as not supported in any way by the evidence.

10. The Alleged Beatings Administered by the Appellants Are Alleged to Have Occurred Subsequent to the Seizure of the Marijuana, and Have No Bearing on the Commission of the Crime Charged.

If treasury agents were to beat or torture a defendant whom they apprehended, the agents should be prosecuted for violation of the civil rights of the defendant but the beating or torture would not wrap the defendant in a cloak of immunity from prosecution for the prior offense.

In the Lozoya case, although the injunction recites that "from the time of his first detection, and including his

arrest, . . . and search and seizure of marijuana” Lozoya was beaten and tortured, the evidence, if properly considered by the Court in connection with the injunction, shows that the altercation or scuffle occurred in the interrogation room subsequent to the sale and transfer of the marijuana, arrest of Lozoya, and the taking of the sack of marijuana into custody. Surely a later alleged beating and torture does not relate back to vitiate the admissibility of unquestioned antecedent testimony. If so, Lozoya has learned as others may, to inveigle the arresting officer into the use of force and to thereby evade payment of the debt owed to society.

To hypothesize: if Lozoya had confessed or admitted anything of an incriminatory nature in connection with the sale or transfer of the marijuana in question, while he was in the interrogation room, the trial court in the wise exercise of judicial discretion might well have declined to receive testimony of the confession or admission so obtained and gaze with keen eyes upon any subsequently obtained admission or confession. But such is not the case in Lozoya where all of the evidence of sale and transfer of marijuana was obtained before the alleged beating except evidence of one tacit admission by Lozoya to Agent Ramirez made later in the County jail.

Conclusion.

The trial court abused its discretion in granting the permanent injunction against appellants, as well as other persons who were not before the court, and in invading the province of the Secretary of the Treasury who alone or by his delegates has the power of disposition of narcotics subsequent to federal trial and withdrawal of the substance from evidence.

An adequate legal remedy existed and this is the primary test of equitable jurisdiction to grant a permanent injunction. Lozoya could assert the alleged defense, former jeopardy, when actually placed in jeopardy by the State of California.

The injunction could be a dangerous precedent as an unjustified interference by the Federal District Court with State law enforcement and prosecution by the state of violations of its laws. It is an unwarranted extension and interpretation of the *Rea* doctrine which will inhibit proper law enforcement and discourage desirable cooperation between federal and state authorities and law enforcement agencies in the future unless dissolved.

Lozoya has never been placed in second or double jeopardy so an injunction on this basis is premature in any court and may only be asserted at an appropriate time in the State or other court which brings Lozoya to an alleged second trial and places him in jeopardy for the same offense for which Lozoya was previously in jeopardy.

Existing law provides that a person may be tried in succession by Federal and then State prosecution, or in inverse order. However, it is not necessary to rely upon the *Lanza* and other cases which support this rule because the attempted and envisaged prosecution of Lozoya by the State of California is for a different offense arising out of the same acts.

If the bases for the injunction be alleged beatings and torture of Lozoya by appellants, three of the appellants were not present at the alleged beatings. With no evidence in support thereof, these three appellants, Ramirez, Goodman and Freeman were wrongfully found to have beaten and tortured Lozoya. Similarly, the State Courts

should not have been enjoined and were not even before the court below.

It is respectfully submitted that the Court below abused its discretion in granting the injunction, that its discretion was exercised to an end not justified by any evidence before it at the hearing or the testimony from the trial and that the injunction is clearly against logic and should be dissolved.

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No. 15468

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOSE RAMIREZ, MEYER GOODMAN, MICHAEL GULLON,
BILL H. FREEMAN and ROBERT E. MILLER,

Appellants,

vs.

REFUGIO GONZALEZ LOZOYA,

Appellee.

REPLY BRIEF OF APPELLANTS.

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FILE

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vs.

REFUGIO GONZALEZ LOZOYA,
Appellee.

REPLY BRIEF OF APPELLANTS.

I.

Criminal Trial Terminated.

In reply to the extravagant claims of appellee's Brief, appellants desire to point out that the federal court trial of appellee terminated with his acquittal on July 20, 1956. Under the Constitution and laws of the United States that terminated the matter for all time. The Government did not have a right of appeal against the court's finding that the defendant was not guilty. The court had no further use for any evidence which was admitted at the trial, including any tangible evidence which was introduced therein. Thereafter, on August 10, 1956, a complaint as to a violation of State laws was made to the District Attorney for the County of Los Angeles,

California, and the State, in accordance with its judicial processes, had the matter set for preliminary hearing on January 11, 1957. On the 4th day of January, 1957, the Honorable Thurmond Clarke, United States District Judge, issued an order to show cause against appellants, which was set for hearing on January 10, 1957, one day before the proposed commencement of the preliminary hearing in the State Court. The order to show cause was entitled with the caption and number of the federal court action which had, as previously indicated, terminated in July of 1956, some six months before. At the so-called "hearing" on January 10, 1957, no evidence was presented. The court indicated that it had not had an opportunity to read the brief of appellants, which was presented in opposition to the petition of appellee.

II.

Decision Made Before "Hearing."

The court also indicated that it had already prejudged the matter and had made up its mind and had written an order which it was going to have entered.

"The Court: Mr. Bender, can't you take the court's word for it that I worked all weekend on this particular case?

Mr. Bender: Yes, your Honor, but you were just handed the brief in opposition.

The Court: Yes, but I am a graduate of a law school, you know. I say I worked all weekend on this particular case and researched the matter. I spent hours on it.

Mr. Bender: Yes, your Honor.

The Court: And the court feels very keenly about this case.

Mr. Bender: Your Honor, from the respondents' position it would be a wrongful thing for the court to enjoin the respondents from testifying in other proceedings elsewhere.

The Court: I know you feel that way, but this court feels on this matter of the order to show cause that when the court has tried this defendant and acquitted the defendant, that should end the matter. The court is going to read its written order at this time, and the court will file an opinion. I am sorry that I disagree with you, but that is the function of the court."

The foregoing indicates that the Judge had prejudged the matter and made up his mind prior to reference to the appellants' trial brief or to any evidence on the matter. In fact, *no evidence was taken by the court*, the entire matter being handled on the basis of the petition of appellee and the argument of counsel at the time of the so-called "hearing."

III.

Findings Unsupported by Evidence.

The petition of appellee complains of a violation of his constitutional rights under the Fifth and Fourteenth Amendments to the Constitution. No mention therein is made of any torture or beatings. Nevertheless, in the court's written Order enjoining the appellants from testifying, the "findings of fact," although not separately set out, were that from the time of appellee's first detection, including his arrest, and interrogation and search and seizure of the subject of the offense, consisting of 9½ pounds of marihuana, incarceration and interrogation, appellee was subjected to beatings and torture by

agents and employees of the United States Government. No such facts were before the court on this separate hearing on the order to show cause, and such findings were not even responsive to, or were the alleged facts included in, the petition of appellee which initiated the hearing on the order to show cause.

Nevertheless, the true intent and character of appellee's action is clear from his brief (p. 14) in which he alleges that an eardrum was broken, as well as other claims and conclusions. The only proof that any injury at all occurred would have to come from the trial transcript of the federal criminal trial which was not before the court in this "hearing." An examination of that transcript [Tr. p. 412], as reproduced in the transcript of record in this case, indicates that this was the allegation made by appellee while he was on the witness stand under a criminal indictment. Appellee concludes that there was a necessary and inherent finding of fact that the entire testimony of appellee was true in his criminal trial. If this were an appeal from the criminal trial, the Government would concede that appellee's position, he being the prevailing party, would have some substance. However, in the instant matter, since there was no evidence before the court upon which any finding could have been made, appellee does not stand in the favored position which he seeks to occupy. *Parks v. Ross*, 52 U. S. 362, 372; *Northwestern Electric Co. v. Federal Power Comm.*, 134 F. 2d 740, *affd.* 321 U. S. 119 (9 Cir., 1943); *Arena Co. v. Minneapolis Gas Co.*, 234 F. 2d 451 (8 Cir., 1956); *Controller of California v. Lockwood*, 193 F. 2d 169, 172 (9 Cir., 1951). Appellee, in his argument, gets a lot of mileage out of the testimony which he gave at the trial and the candid ad-

missions by some of appellants of their activities at the time they attempted to book appellee. His distorted version of the facts now indicates that he was handcuffed to a chair during the alleged beating. The facts adduced at the federal trial do not indicate that such was the case. Rather they indicate that he was a reluctant arrestee and that he had to be subdued in order to take his fingerprints. He now says that "guilty parties" (who did not have a trial to ascertain their guilt of his alleged charges) may not profit from their own wrong. He does not indicate how the appellants, who are narcotics officers charged with the prevention of traffic in marihuana and other narcotics, would profit from the trial of appellee on a State charge of possession of marihuana. He also makes the statement in his brief (p. 14) that the "guilty" Government agents should not be allowed to proceed in another forum. It is fundamental that a Government agent does not proceed in court, but that the action in this instance is carried on by the People of the State of California.

IV.

Injunction Derogates Reserved State Powers.

Appellants are certainly within their rights when they claim that the federal judge has no right or duty to interfere with or restrain the legitimate and normal processes of law enforcement in the State of California. No question of due process of law is involved in the instant set of facts. Appellee would subject, by prior restraint, the operation of State law enforcement agencies to federal control, completely ignoring the constitutional reservations of power to the states. (U. S. Const., Tenth

Amend.) His position presumes that state courts are not competent to inquire into alleged wrongs and to deal with them fairly, and gives the federal court power to prevent state courts from even hearing evidence in a matter which is related to a prior federal court trial. This, appellee contends, is an inherent power of the federal District Courts, notwithstanding the limited jurisdiction which has historically been ascribed to such courts. *The Gerald A. Fagan*, 47 F. 2d 215, affd. 284 U. S. 263 (2 Cir., 1931); *Concord Casualty & Surety Co. v. United States*, 69 F. 2d 78, 80 (2 Cir., 1934). Title 28, U. S. C., Section 2283:

“A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.”

This is not to be confused with the right of federal *appellate* courts to review, on due process grounds, the judgments of state courts *after trial*.

Appellee concludes, without citation of supporting evidence, that appellants were “concerned with eliciting a confession by beatings and torture, rather than in booking appellee.” (Appellee’s Br. p. 19.) This is a completely distorted version of the facts which were before the federal trial court when it was hearing the criminal trial. The testimony in that trial was of a resistance to being fingerprinted on the part of the appellee. Most of the appellants were not even present at that time. Furthermore, it does not necessarily follow, without special findings of fact by the trial court, that any particular testimony of either appellants or appellee was found to

be true, unless that testimony was essential to the finding of innocence by the trial court in the federal criminal trial. Cf. *Hammel v. Little*, 87 F. 2d 90 (D. C. Cir., 1936); *New York Life Ins. Co. v. Murdaugh*, 94 F. 2d 104 (4 Cir., 1938); *United States v. Bridges*, 123 F. Supp. 705 (D. C. Calif., 1954); *Melvering v. Mitchell*, 303 U. S. 391; *Boundary County, Idaho v. Woldron*, 144 F. 2d 17, cert. den. 324 U. S. 843 (9 Cir., 1944) (see also 49 F. Supp. 600). Previous judge entered an order without first entering findings of fact. Later, cause was resubmitted to another judge. Held: Previous ruling not binding on second judge. Here, there was no evidence before the court on the hearing on order to show cause which would support the findings which were made at that time.

Appellee cites the case of *McNabb v. United States*, 318 U. S. 332, and quotes as follows:

"Judicial supervision of the administration of criminal justice in the *federal courts* implies the duty of establishing and maintaining civilized standards of procedure and evidence." (Emphasis added.)

Appellants have no quarrel with this quotation, but what is involved in this action is the supervision of the administration of criminal justice in the *state courts*. The duty of the federal courts in that regard is not clear and not supported by the citations of appellee. If the appellee is denied due process in a state court trial, then after the trial his eventual appeal could be to a proper United States appellate court which could consider the lack of due process.

V.

No Evidence to View Favorably.

Appellee's second point alleges that the evidence "must be viewed most favorably to the judgment appealed from." Appellant respectfully inquire: "What evidence"? It certainly has always been true in civil matters that the party who lost in the trial court can point out and assert the factual deficiency to support any findings made by the trial court. *Parks v. Ross*, 52 U. S. 362, 372; *Northwestern Electric Co. v. Federal Power Comm.*, 134 F. 2d 740, affd. 321 U. S. 119 (9 Cir., 1943); *Arena Co. v. Minneapolis Gas Co.*, 234 F. 2d 451 (8 Cir., 1956); *Controller of California v. Lockwood*, 193 F. 2d 169, 172 (9 Cir., 1951). The Government was not permitted to present evidence in the order to show cause hearing. The court's mind was made up, as has been indicated *supra*. Certainly appellants have a right to a fair trial, and that goes to each of the appellants separately. It must be borne in mind that *different issues* were presented to the trial court by virtue of the petition and order to show cause, and *appellants certainly had a right to present any evidence they had on those issues*.

Appellee has deliberately, or erroneously, misquoted from the trial transcript in the federal criminal action [Tr. p. 364] by stating that "Agent Gullon paused *and hedged*." (Italics added by appellants, not in trial transcript.) This type of treatment has characterized the entire approach to this matter, appellee making reckless conclusions and assertions as to what was before the trial court. The court itself, which is supposed to be an impartial arbiter of the hearing on order to show cause, had prepared its final order without permitting the ap-

pellants to make any case whatsoever in their own behalf. His decision was reached before the time for filing appellants' answer had passed and before the day set for hearing. [Tr. pp. 458-566.]

VI.

New Issues Presented by Order to Show Cause.

Appellants repeat that there was absolutely no evidence before the court upon which to base findings and the order which was issued. Evidence at the criminal trial was necessarily restricted to the issues before the court at that time, especially the evidence which the Government could present in its prosecution of appellee. New issues are before the court on the order to show cause, but neither side presented, nor was permitted to present, any evidence thereon. Hence, there was no evidence before the trial court. Thus appellee's cases concerning the finality of findings of fact of the trial court are inapplicable to the issues now presented to this Honorable Court.

There was no evidence of beatings or participation therein by appellants Goodman, Ramirez and Freeman before the federal court in the trial of the criminal matter, and, of course, no evidence whatsoever before it on the order to show cause. Even appellee in his wildest assertions in the federal criminal trial did not attempt to include these named individuals in his charges.

Appellants' appeal is not based on "their version of the evidence" as claimed by appellee (Appellee's Br. p. 22, lines 4 and 5) because there is no evidence. However, appellants discussed certain of the evidence which was submitted in the federal criminal trial, a trial for an

alleged narcotics offense in which the issues were different and in which Government agents were not on trial, and therefore had no opportunity to defend themselves. If this is due process to appellants in an order to show cause hearing in which they are "convicted" of torture and beatings, and accords with the traditional American concept of opportunity to be heard and to defend oneself, then it is news to this writer.

VII.

Court Has Duty to Take Evidence.

Appellee suggests that appellants did not request the taking of testimony. Since when is it necessary to ask that evidence be taken upon charges which are made against individuals and to support the allegations of a moving party? Appellants have always understood that a person charged with the commission of some sort of offense was entitled to have the evidence presented against him prior to a judgment being rendered. Can appellants be accused of defaulting when the trial judge would not even pay attention to their timely filed trial brief? Are they required to go through useless motions? Are they required to defend themselves when they are not even charged in the petition of appellee with any wrongful acts? Appellee suggests

"that the learned trial judge was not required to *rehear* (*sic*) the testimony in order to issue the order appealed from." (Appellants' Br. p. 22, lines 21-22.)

And then concludes:

" . . . that the court was entirely cognizant of the facts." (Appellee's Br. p. 22, lines 21-22.)

Appellee's unique suggestion appears to be, since the court had heard some evidence in a different trial some six months before, that it now could be taken to be cognizant of "the facts." He glibly passes over the fact that in his petition he did not allege torture or beatings or any right to redress on that account, but was claiming instead that he was being placed in double jeopardy.

VIII.

Appellee Abandons Position in Trial Court.

He just as glibly now abandons his position regarding double jeopardy (Appellee's Br. p. 40, lines 21-22) so that now the matter has changed from a proceeding alleging that appellee was denied due process in that he was being subjected to double jeopardy, which the appellants' citations have shown clearly not to be the fact (see Appellants' Op. Br. Point No. 2), and now assumes a position not even taken in his petition, but erroneously adopted by the federal district judge in his order entered at the time of the "hearing" on the order to show cause. Again appellants respectfully point out that the matters at issue before the federal District Court in its federal criminal trial were not the same matters which would necessarily be in issue under the appellee's petition which initiated the order to show cause hearing.

IX.

No Fruits of Alleged Conduct.

There was no evidence before the court at the time it made its order in apparent response to the order to show cause hearing. The discussion of evidence which has been engaged in in the briefs was that which was before the trial court at Lozoya's trial on the marihuana charges,

not that which was at issue on the order to show cause hearing. Again, appellants point out that the judge heard that evidence six months before, and unquestionably his memory is subject to the same shortcomings as those of many individuals.

Appellee points out (Appellee's Br. p. 24, line 13), irrespective of the alleged treatment by appellants, he "refused to make any admissions." Thus, if beatings were administered by some of appellants, it is clear that no fruits of the incident were forthcoming. There was no illegally obtained evidence. There were no confessions. There was no admission. And finally, there was no evidence before the trial court. Therefore there was nothing upon which the trial judge could base his alleged findings of fact.

X.

No Joint Action.

The order by the trial court purports to find that there were beatings and torture. There is no indication in the transcript of the criminal trial of any participation therein as to Agents Goodman, Ramirez or Freeman. They are now roped into the alleged acts of the officer officers, Gullon and Miller, on the ground that they were participating in the surveillance and arrest of appellee. The finding of such vicarious liability for the wrongs of others is not consonant with the standards of due process which should be accorded all of the appellants just as surely as it should be accorded the appellee. Cf. *Rich v. Warren*, 123 F. 2d 198 (6 Cir., 1941); *Fidelity & Casualty of New York v. Brightman*, 53 F. 2d 161 (8 Cir., 1931). He wants to parlay the alleged wrongs of some

appellants into complete freedom from any charge of criminal misfeasance irrespective of his very apparent implication therein. (Note, there is no claim of innocence of the State crime anywhere in appellee's Brief or other documents.) That appellants were engaged in the joint activity of attempting to impede the violation of the narcotics laws is admitted. This is not to say that appellants who had no part in alleged "beatings and torture" counselled, assisted in, or conspired to treat appellee in that manner. Appellants Goodman, Romirez and Freeman were doing their duty as prescribed by their superiors and in accordance with the law. If some of their associates did commit wrongful acts, the named individuals are certainly not responsible therefor unless they advised or assisted therein in some manner. *Cf. Rich v. Warren*, 123 F. 2d 198 (6 Cir., 1941); *Fidelity & Casualty of New York v. Brightman*, 53 F. 2d 161 (8 Cir., 1931). No such proof was presented even in the federal criminal trial of Lozoya.

Whatever other rights of appellee were offended by the alleged beatings and torture, if such were the case, he had due process in his federal criminal trial, and is guaranteed due process in the State courts of the State of California, under both the California and the United States Constitutions.

XI.

Separation of Powers Doctrine Applies.

Federal courts do not have *general* supervisory control over Government agents. (But *cf. Rea v. United States*, 350 U. S. 214, 76 S. Ct. 292.)

The federal courts have historically been accorded the pre-eminent and predominant position in judicial matters

as distinguished from executive and legislative. They have not, however, occupied such position in connection with matters under the direct supervision and control of the executive. This is the well known doctrine of separation of powers. It is true that the courts have recently stated that they have such supervisory control where Government agents seek to use illegally obtained evidence in a state trial. *Rea v. United States*, 350 U. S. 214, 76 S. Ct. 292. Such is not the present case.

Assuming *arguendo* that federal courts have such *general* supervisory control, the cases relied on by appellee in his Brief involve illegal searches and seizures, and resultant illegally obtained evidence. No such situation is here presented. No federal rule has been violated in the alleged actions of the appellants, if the allegations of their actions are proved to be true by competent evidence. This distinguishes the *Rea* case, *Rea v. United States*, 350 U. S. 214, 76 S. Ct. 292.

XII.

Federal Court's Action Impedes State Courts.

The federal District Courts certainly have no supervisory control over state courts. The instant proceeding is an unwarranted interference with the operation of the state courts, and with the executive of the states in their right to control and prosecute illicit traffic in marihuana. Again this distinguishes the instant situation from that in *Rea*. In that regard the attention of the court is respectfully directed to the language of the order restraining federal officers, as issued by the learned trial judge, which

“permanently enjoined from testifying concerning the subject of said detention, apprehension, arrest, in-

terrogation and the search and seizure of said 9½ pounds of marihuana,” all of appellants, “and said parties, together with their agents, associates and any parties having the said 9½ pounds of marihuana are ordered to forthwith return and deposit the same with the Clerk of this courtroom, and *all persons are restrained from ordering and compelling the parties enjoined herein, from testifying in any proceeding.*” (Emphasis added.)

XIII.

Appellants Denied Due Process.

Appellee in his Brief (p. 29, lines 6-10) aptly cites the language of Douglas, J., in *Williams v. United States*, 341 U. S. 97, but states that it governs the conduct of appellants. The language follows: “It is the right of the accused to be tried by a legally constituted court, not by a kangaroo court.” Appellants respectfully point out that in this proceeding on the order to show cause they are the persons who were tried and convicted without hearing. The federal proceeding had terminated as to appellee. Appellants are the ones who got the kangaroo court and were not permitted to submit evidence, nor was their brief in opposition even read or considered by the trial court.

Again, on page 31 of appellee’s Brief, lines 4 through 11, appellee cites more helpful language from *Rea v. United States*, 350 U. S. 214, as follows:

“ . . . It was within the power of the court to take jurisdiction of the subject of the return and pass upon it as the *result of its inherent authority to consider and decide questions arising before it concerning an alleged unreasonable exertion of authority in*

connection with the execution of a process of the court. No injunction is sought against a state official.” (Emphasis added.)

The petition which gave rise to the order of the District Court does not cite any “alleged unreasonable exertion of authority in connection with the execution of a process of the court.” This would seem to undermine the appellee’s contention that the court has inherent authority in the matter before it to issue the injunction.

And whereas in the *Rea* case, *supra*, no injunction was sought against a state official, the injunction here issued purported to enjoin and restrain all persons from ordering and compelling the parties (appellants) enjoined herein, from testifying in any proceeding. That would enjoin them from testifying in a state court and would inferentially enjoin state officers from issuing subpoenas and compelling them to testify. All of this despite the fact that none of the evidence was held to be illegal in any way.

XIV.

Appellee Has Available Proper Remedies.

No one sanctions or approves the conduct alleged as to certain of the appellants, if it occurred. It is easy for one accused of crime to allege that he has been mistreated by the officers. Where no evidence is obtained by virtue of such alleged acts, proper procedure to vindicate the wrong would be by way of a complaint against a wrongdoer under existing state or federal laws, not by interference with the functions of state law enforcement merely on the basis of the accusations of one individual who has a particular interest in the proceedings.

Appellee alleges (Appellee's Br. p. 33, lines 15-20) that to deny the injunction in this case would have the effect of annulling the vindication of the defendant in the federal court, and would stultify the fundamentals of liberty and justice secured by the Fourteenth Amendment. These stirring phrases are a conclusion which is clearly not true. The vindication of defendant in the federal court will stand for all time. The question now is whether or not the State court is entitled to proceed for an alleged violation of State laws.

Appellants are indebted to appellee for the citation of *McNabb v. United States*, 318 U. S. 332, 340 (Appellee's Br. p. 34, line 15, through p. 35). The United States Supreme Court is here clearly defining a difference in federal court's supervisory control of federal officers in federal matters and its supervision when they are involved in state court matters. That distinction gives little comfort to appellee's position.

XV.

Marihuana No Longer Subject to Court Control.

The marihuana was not subject to further control by the court after the appellee was acquitted in the federal trial. There was no longer any concern by the court of the marihuana as evidence since the United States of America has no appeal in such acquittal. Appellants adhere to their position as stated in the opening brief, notwithstanding the criticisms of that position entertained by appellee in his Brief under Point Six at page 37, *et seq.*

Appellee attempts to confuse and apply the legitimate rules preventing a return of contraband to the person who

possessed it, *e.g.*, marihuana, to the individuals from whom it was obtained (even if so obtained illegally), with the right and duty of law enforcement officials to cooperate with and make evidence available to other agencies of law enforcement and to other courts. This rule is undoubtedly invoked to protect society from further misuse of the contraband, or further danger from it, and the rule should not be strained to defeat the legitimate use of the evidence as such in a trial before a competent tribunal. Furthermore, the executive is charged with the destruction of contraband, as indicated in the appellants' Opening Brief.

There is no problem of an illegal seizure as in the *Rea* case. The appellants deny the allegation that the withdrawal was not done pursuant to order or decree of any court of the United States having jurisdiction thereof, as alleged by appellee on page 40 of his Brief. As set out in the Opening Brief of appellants, the withdrawal was made pursuant to the rule of the local federal District Court. This provides for the withdrawal of all exhibits after time for appeal has run in the event an appeal is available. Rule 20(a), Local Rules of United States District Court for the Southern District of California, first paragraph.

XVI.

Appellee Concedes That Double Jeopardy, Which Was the Sole Basis for His Original Petition Which Brought About the Order to Show Cause, Is No Longer at Issue in This Matter (Appellee's Br. p. 40, lines 21, 22).

Neither do appellants agree with the appellee's conclusion as to the meaning of Section 2463, Title 28, United States Code Annotated, as previously indicated in this reply.

By the failure to reply to any of the points made by appellee the appellants do not thereby indicate concurrence in appellee's position. The matters have not been considered sufficiently important to present further argument since it is the contention of appellants that all of the matters raised in appellee's Brief have previously been covered in one manner or another by appellants' Opening Brief. This note of caution is added in order that appellants will not be considered to have waived any of their position as stated in the Opening Brief.

Wherefore, appellants pray that the position they have presented be sustained by this court; that the action of the trial court in issuing a permanent injunction against appellants be reversed, and that the trial court be ordered to dissolve its injunction, and to refrain from further interference in the processes of the State court.

Respectfully submitted,

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United States Court of Appeals

For the Ninth Circuit

ELICK D. TITTMAN,

Appellant,

vs.

GREAT NORTHERN RAILWAY COMPANY,
a corporation,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
THE EASTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

BRIEF OF APPELLEE

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United States Court of Appeals
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ELICK D. TITTMAN,

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Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
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BRIEF OF APPELLEE

STATEMENT ON JURISDICTION

This is an appeal from a judgment dismissing appellant's action for damages for personal injuries, after trial to the court, without a jury, and the entry of Findings of Fact and Conclusions of Law. The suit was brought under the Federal Employers' Liability Act, Title 45 USCA, Section 51, *et seq.* The District Court had jurisdiction of the cause by virtue of Title 28 USCA, Section 1331.

The jurisdiction of the Court of Appeals is invoked under Title 28 USCA, Section 1291.

Reference is made to the pleadings: the Complaint (R. 1), the Findings of Fact and Conclusions of Law (R. 10-15), Objections to Findings of Fact and Conclusions of Law (R. 16-22), and the Judgment of the District Court (R. 8).

STATEMENT OF THE CASE

Appellant filed this action for damages under the Federal Employers' Liability Act for personal injuries alleged to have been sustained by him on June 8, 1955, while in the employ of the appellee. At that time, appellant, a brakeman, was said to be walking between train yard tracks Nos. 12 and 13 in appellee's Hillyard Yards at Spokane, when he claims to have tripped over a piece of baling wire and fell to the ground.

This case came on for trial on December 10, 1956, before the court sitting without a jury. After four days of trial, in which both parties put in their full case and both parties had rested, the court took the case under advisement. On December 31, 1956, the court entered findings of fact, conclusions of law, and judgment dismissing the case on the merits. On January 10, 1957, appellant filed objections to the findings of fact and conclusions of law, motion to amend, and proposed judgment, which were rejected by the trial court.

Appellant has appealed from the final judgment entered in this case on December 31, 1956. In perfecting said appeal, appellant filed his concise statement of points on appeal, in which he set forth the following:

“The Court erred in failing to find in favor of plaintiff and against defendant in that the evidence conclusively established that defendant was negligent and liable for plaintiff's injuries.”

This appeal involves a question of whether or not the trial court erred in finding for the appellee and against the appellant after an adjudication of the merits of the case. The trial court having entered find-

ings of fact pursuant to Rule 52 of the Federal Rules of Civil Procedure, said findings of fact shall not be set aside unless clearly erroneous. More precisely then, the two questions to be determined upon this appeal are:

1. Whether there is any evidence to support the findings of fact;
2. Whether the court erred as a matter of law.

Notwithstanding the above, appellant in his statement of the case would have the appellate court completely disregard the findings of fact and conclusions of law and treat this case as though either a motion for dismissal had been granted at the end of the plaintiff's case or a verdict directed for the defendant had there been a jury. Of course, neither happened in this case. Thus, appellant's statement that the question involved is whether there was sufficient evidence of negligence on the part of appellee to justify submission of the case to a jury, if there had been one, is inaccurate.

The findings of fact and conclusions of law entered by the trial court became the law of the case. Under Rule 41(b) of the Federal Rules of Civil Procedure, the judgment of dismissal, being based upon grounds other than lack of jurisdiction or improper venue, operated as an adjudication upon the merits.

Appellant is not now in a position to insist that this court go behind the findings of fact, conclusions of law and judgment and consider whether the case should have been submitted to a jury, had there been one, merely by reason of certain statements made by the trial court in announcing its oral decision. Moreover, a complete reading of the court's oral opinion, together with the findings of fact and conclusions of law entered

thereafter, make it quite apparent that the trial court did consider all the evidence necessary in arriving at its decision, including the evidence necessary to determine whether or not the doctrine of *res ipsa loquitur* was applicable.

ARGUMENT

I.

Appellant is bound by the Trial Court's Findings of Fact, unless clearly erroneous.

Finding of Fact No. VI (R. 12):

“That no evidence was presented as to where the coil of wire over which plaintiff testified he fell had come from or how long it had been there. Undisputed evidence was presented that said Hill-yard Yards and the area lying between train yard tracks 12 and 13 at the location where plaintiff fell, was inspected and cleaned on June 8, 1955, the day of said accident; and had been inspected and cleaned on June 7th and June 6th, immediately prior thereto. The undisputed evidence further shows that no wire was used by the car repairmen in making light repairs upon railroad cars when located on train yard tracks 12 and 13 and, in particular, in the area in which the plaintiff fell. There was a complete absence of any evidence that wire of any kind had ever been placed, left or even seen at any time in the area in which the plaintiff fell or at any points between train yard tracks 12 and 13.”

Finding of Fact No. VII (R. 13):

“The undisputed evidence was that the area be-

tween train yard tracks 12 and 13, including the area where the plaintiff fell, were clean and free of debris on the afternoon of June 8, 1955, after they had been inspected and cleaned that day."

Finding of Fact No. VIII (R. 13):

"There was no evidence that the defendant: (a) negligently failed and neglected to properly and frequently inspect the Hillyard Yards and keep the same in a neat condition, (b) that the defendant negligently failed and neglected to keep the area or footpath between train yard tracks 12 and 13 clear of wire and other debris, which area or footpath plaintiff was required to use in the performance of his duties, (c) that the defendant carelessly and negligently placed, left or allowed to remain, the coil of wire heretofore referred to in the area or footpath which plaintiff used while inspecting the train upon which he was working, (d) that the defendant negligently failed and neglected to warn or advise the plaintiff of the existence of said coil of wire prior to the time that the plaintiff was required to work in said area or footpath."

Based upon these Findings of Fact, the court made, among others, the following Conclusions of Law:

Conclusion of Law No. III (R. 14):

"That the evidence was insufficient to impute either actual or constructive notice to the defendant of the existence of said wire, so as to render it negligent merely by reason of its being there when plaintiff tripped over it."

Conclusion of Law No. IV (R. 14):

“That the doctrine of *res ipsa loquitur* is not applicable under the evidence presented in this case.”

Conclusion of Law No. V (R. 14):

“That any injuries or damages which the plaintiff may have sustained as a result of said fall were not proximately caused by the negligence of the defendant in failing to exercise reasonable care in the inspection and maintenance of its yards where the plaintiff was required to work or in providing him with a reasonably safe place in which to work.”

This is an action at law for damages. Thus, as heretofore stated, Rule 52 expressly provides:

“Findings of fact shall not be set aside unless clearly erroneous, . . . ”

The adoption of this rule by the Supreme Court was merely a restatement of the overwhelming weight of authority established in a long line of Federal cases. Thus, the following tenets have been so clearly established by legions of Federal cases that they should hardly require citation of authority in support thereof:

(1) Findings of fact by a court sitting without a jury are equivalent to a verdict, and hence will be disturbed only when they appear clearly erroneous, or show that the judge was influenced by improper motives, or misunderstood the evidence.

(2) Trial Judges' findings are never to be lightly disturbed by a reviewing court.

(3) A court of appeals must accept findings of fact unless clearly and manifestly wrong.

(4) Findings of trial judge on questions of fact should be given great weight.

(5) Findings of trial court on issues of fact will not ordinarily be disturbed except for obvious errors in the application of the law, or serious mistake in the consideration of the proof.

(6) If there is any substantial evidence to support the finding of the trial court, the appellate court in a proceeding in error will not consider the weight of the evidence.

(7) Weight of evidence is not for consideration by appellate court, where the conclusions of the trial judge are supported by evidence.

(8) In a law action tried without a jury, fact-finding contrary to weight of evidence is error of fact not reviewable.

(9) Findings of fact based on conflicting evidence will not be disturbed on appeal unless against the clear preponderance of the evidence.

(10) Findings of fact on conflicting evidence will not be disturbed where supported by substantial testimony.

(11) A reviewing court will not disturb the finding of the court below, where evidence submitted there leaves a question of fact in doubt.

(12) A finding by the court on conflicting evidence has the force of a verdict, and will not be disturbed on appeal.

(13) Findings by court sitting without a jury will be taken as true if supported by any substantial evidence.

(14) The trial judge's findings on pure matters of fact or mixed matters of law and fact, are alike conclusive when supported by submissible evidence.

And where there is evidence to justify the trial court's findings, the appellate court is not concerned with the mental processes of the trial court. *Wessel v. United States*, 49 F.(2d) 137. Errors alleged in findings of court are not subject to revision if there is any evidence upon which such a finding could be made. *United States v. Washington Dehydrated Food Co.*, 89 F.(2d) 606. In fact, it has been held that judgment for defendant on facts found can be erroneous only when judgment for plaintiff is imperative. *Luttrell v. United States*, 41 F.(2d) 517, affirming *Petree v. United States*, 34 F.(2d) 563, certiorari denied 51 S.Ct. 82, 282 U.S. 877, 75 L.ed. 775.

Appellant can prevail in this case, then, only upon a showing that there was an error of law committed, or that the findings are clearly erroneous. He cannot go back of the judgment and findings and create a reviewable issue for this court on the question of whether or not there was evidence which could have been submitted to a jury, had there been a jury. The trial court was the trier of the facts, and performed the duties and function of the jury. The mere fact that the evidence was such that the court, in commenting on the evidence, was prone to say that there was not even sufficient evidence of negligence to submit to a jury, had there been

one, cannot convert this case into a mere review of that issue. Indeed, the appellant himself recognizes that fact, for in spite of his ingenious argument, he does not ask that this court remand the case for the purpose of the trial court making additional findings of fact, or a new trial, but asks that this court find for the appellant, and order the entry of a judgment in his favor. In doing so he attacks the accuracy of the court's Findings of Fact VI, VII and VIII, and relies upon disputed or conflicting testimony as to whether wire of the type described by the appellant was used by the railroad. Thus, while he in one breath contends that the court erred for not considering all the evidence, he in the next breath tacitly admits that the court considered all the evidence necessary to arrive at its decision, when he attacks findings of fact which must have been based upon disputed or conflicting evidence if his contention is correct.

The mere fact that a trier of the facts might feel that the evidence was not even strong enough to submit the issue of negligence to the jury, if there had been one, does not remove the effect to be given to its findings of fact entered in support of its judgment, especially where said findings of fact are made and based upon all of the evidence necessary to consider in making them, and at the conclusion of the entire case. Such a belief, if anything, makes all the more binding and conclusive the trial court's findings of facts, unless those findings themselves were clearly erroneous.

Actually, what appellant is really arguing is the weight to be given particular evidence, which, of course,

is not a matter which this court will consider on appeal. As was said in *United States v. Gamble-Skogmo*, 91 F.(2d) 372, when an action at law is tried to the court, the court's fact findings are conclusive in courts of review, no matter how convincing the argument that findings should have been different under the evidence. Where the court's findings of fact in a law action tried without a jury are based upon substantial evidence, they are conclusive upon the appellate court, no matter how convincing the argument be that upon the evidence the findings should have been different. *Davies v. Home Trust Co.*, 83 F.(2d) 124. The weight of the testimony is not for consideration by the appellate court, where the conclusions of the trial judge are supported by the evidence. *Aetna Ins. Co. of Hartford, Conn. v. Licking Valley Milling Co.*, 19 F.(2d) 177, certiorari denied 48 S.Ct. 37, 275 U.S. 541, 72 L.ed. 415. Where there is substantial evidence to support the finding of the trial court, it is immaterial that the appellate court might differ with the processes of reasoning employed by the trial court to reach said finding. *Conqueror Trust Co. v. Fidelity & Deposit Co. of Maryland*, 63 F.(2d) 833. The long and short of it is, that the appellate court will not substitute its judgment for that of the trier of the facts, where there is any substantial evidence to support the trial court's findings.

Nor will it avail appellant to contend that by reason of the statement of the trial court in his oral opinion that he was granting the defendant's motion for dismissal on the grounds of the insufficiency of the evidence, that this court must now determine whether or

not the evidence considered in a light most favorable to the plaintiff presents a prima facie case for relief. No motion was made to dismiss this action at the end of the appellant's case. At the end of the trial, appellee's counsel did move to dismiss the case on the grounds of the legal insufficiency of the evidence. The court noted the motion for the record, and thereafter appellant's and appellee's counsel fully argued the merits of the case, based upon all the testimony, in their closing arguments. And the court in deciding the case and entering its findings of fact and conclusions of law considered the case on its merits. While at one point in its oral opinion the trial court did indicate that he was going to grant the motion to dismiss, it is obvious when the whole opinion is read that the court thoroughly weighed and considered all the evidence necessary to decide the case on its merits.

But even if we were to assume for the sake of argument, that this situation was similar to that where a motion for dismissal is made at the end of the plaintiff's case, this Circuit together with the Sixth and Seventh Circuits, has firmly held that on such a motion the court has the power to finally dispose of the case and that it is its duty to do so. See *Gary Theatre Co. v. Columbia Pictures Corporation*, 120 F.(2d) 891 (C.C.A. 7); *Young v. United States*, 111 F.(2d) 823 (C. C.A. 9); *Bach v. Friden Calculating Mach. Co.*, 148 F.(2d) 407 (C.C.A. 6). In *United States v. Borden Co.*, 111 F. Supp. 562, the plaintiff contended that the court in disposing of an involuntary motion for dismissal at the end of plaintiff's case was precluded from weighing the evidence. The court in considering the

question, quoted from *Allred v. Sasser*, 7th Circuit, 170 F.(2d) 233, 235, as follows:

“The trial court was the trier of the facts, and in considering the evidence was not bound to view it in a light most favorable to the plaintiff, with all attendant favorable presumptions, but was bound to take an unbiased view of all the evidence, direct and circumstantial, and accord it such weight as he believed it entitled to receive.”

See also *United States v. Bartholomew*, 137 F. Supp. 700.

II.

There is substantial evidence to support the findings and conclusions.

With the foregoing in mind let us now turn to the facts to determine whether or not there is any substantial evidence upon which to support the trial court's findings of fact and conclusions of law.

Appellant's action was based upon a charge of negligence on the part of the appellee in the maintenance of its Hillyard Yards at the point where the accident occurred. Specifically, in paragraph IV of the complaint (R. 3), appellant alleged negligence of the appellee as follows:

“(a) That defendant in violation of the aforesaid rule, negligently failed and neglected to properly and frequently inspect the aforesaid yards and to keep the same maintained in a neat condition.

(b) That the defendant negligently failed and neglected to keep the foot path alongside the track where said train was about to depart, clear of wire and other debris which was scattered along said foot path, which plaintiff was required to use in the performance of his duty.

(c) That defendant carelessly and negligently placed the aforesaid coil of wire on said foot path and permitted the same to be placed and remain there and did remain there for a sufficient length of time where defendant in the exercise of care and diligence could have discovered the same in time to remove it from the pathway alongside said track which the plaintiff has to pass upon in the performance of his duties.

(d) That defendant negligently failed and neglected to warn or advise plaintiff to be on the lookout for said coil of wire and other debris prior to the time plaintiff was required to use said foot-path."

The trial court held that plaintiff failed to prove this alleged negligence. The court based its holding partly on testimony of the appellant himself, and partly on testimony of appellee's witnesses; particularly that portion of the testimony pertaining to the inspection and cleaning of the yards. It was conceded by all, including the appellant, that no one knew where the coil of wire over which appellant testified he fell had come from or how long it had been there (R. 178). At the same time, undisputed evidence was presented that the area in which the accident occurred was inspected and

cleaned on the morning of the day of the accident and had been inspected and cleaned on the two previous days (R. 350, 360, 368, 373, 374, 393). The undisputed evidence further showed that no wire was used by the car repairmen in making light repairs upon the railroad cars in the area in which the appellant fell (R. 386). There was a complete absence of any evidence that wire of any kind had ever been placed, left or even seen at any time in the area in which the appellant fell, or at any points between train yard tracks 12 and 13, except for the piece of wire which the appellant himself testified caused him to fall (R. 368, 407, 413). There was, in addition, undisputed evidence that the area between the train yard tracks where the appellant fell were clean and free of debris on the afternoon of the day he fell (R. 391, 410), after they had been inspected and cleaned that day.

Based upon that evidence, the trial court's findings are clearly not erroneous.

Under the Federal Employers' Liability Act, 45 U. S.C.A., Section 51 *et seq.*, a defendant employer can be held liable only for negligence proximately causing the injury. *Northern Pacific Railway Company v. Mely* (9th Cir.), 219 F.(2d) 199; *Wilkerson v. McCarthy*, 336 U.S. 53, 69 S.Ct. 413, 93 L.ed. 497. Liability cannot be predicated upon mere speculation. *Tennant v. Peoria & Pekin Union R. Co.*, 321 U.S. 29, 64 S. Ct. 409, 88 L. ed. 520; *Brady v. Southern R. Co.*, 320 U.S. 476, 64 S. Ct. 232, 88 L.ed. 239; *Campbell v. Southern Pac.*, 120 Or. 122, 250 Pac. 622. In *Tennant v. Peoria & Pekin R. Co.*, *supra*, the Supreme Court stated at page 32:

“In order to recover under the Federal Employers’ Liability Act, it was incumbent upon petitioner to prove that respondent was negligent and that such negligence was the proximate cause in whole or in part of the fatal accident.” (Citing cases.)

“Petitioner was required to present probative facts from which the negligence and the casual relation could reasonably be inferred. ‘The essential requirement is that mere speculation be not allowed to do duty for probative facts. after making due allowance for all reasonably possible inferences favoring the party whose case is attacked.’ ” (Citing cases.)

The duty of the appellee in connection with the maintenance of its train yard at Hillyard was not an extraordinary one. The Hillyard Yards are large. Many trains operate in and through it, including trains of the Spokane, Portland & Seattle Railway (R. 179). Its duty was to exercise reasonable and ordinary care in view of all the circumstances. The common law rules for determining negligence on the part of an employer towards his employee are controlling on the question as to what constitutes negligence on the part of the employer. *McGivern v. Northern Pac. Ry. Co.*, 132 F.(2d) 213.

The defendant is not the insurer of the safety of its employees and is not under any obligation to keep the premises absolutely safe. *Patton v. Texas & P. R. Co.*, 179 U.S. 658, 21 S.Ct. 275, 45 L.ed. 361; *McPherson v. Oregon Trunk Ry.*, 165 Or. 1, 102 P.(2d) 726.

Failure to guard against the bare possibility of accident is not actionable negligence. *Brady v. Southern R. Co.*, *supra*. The plaintiff must present more than a mere scintilla of evidence of negligence. Substantial evidence is required. *Poe v. Illinois Cent. R. Co.*, 335 Mo. 507, 73 S.W.(2d) 779.

Applying the evidence in this case in a light even most favorable to the appellant, the only evidence we have is that appellant tripped over a coil of wire while walking alongside of a box car in the Hillyard Yards at Spokane. There is no evidence as to how the coil of wire got there, how long it had been there, that the appellee or any of its employees knew it was there, or that the appellee or its employees had a reasonable opportunity to discover and remove it.

Before appellant's evidence is sufficient to constitute an unsafe place to work or negligence upon the part of the appellee, a showing must be made one way or another that the railroad permitted the coil of wire to be left along its tracks, well knowing that it would constitute a danger to workers in that area. *Brown v. Western Railway of Alabama*, 338 U.S. 294, 94 L.ed. 100; *Bailey v. Central Vermont R. Co.*, 319 U.S. 350, 87 L.ed. 1444.

In *Thompson v. Thompson*, 362 Mo. 73, 240 S.W. (2d) 137, the court reversed a verdict for the plaintiff for injuries sustained when he slipped on the deck or apron of an engine by reason of oil being present thereon, which plaintiff alleged that the railroad had actual or constructive knowledge of the presence thereof. It said at page 140:

“In short, the only evidence concerning oil is that there was some on the apron after Mr. Thompson fell. He saw it and his helper saw it and cleaned it up. But when the oil got there, how it got there and how long it had been there is not to be even conjectured from a single circumstance in the record. The jury’s ultimate conclusion and findings of notice, *Schonlau v. Terminal R. Ass’n of St. Louis*, 357 Mo. 1108, 212 S.W.(2d) 420, rests solely on the two circumstances that the engine was in the yards, ‘on the spot,’ from 10:30 until 3:30 and that the presence of oil upon the apron after Mr. Thompson fell. All the evidence negatives any possible inference that the oil got on the apron through the agency of any employee and therefore there is no possible basis for the necessary inference that the railroad had or could have had notice of its presence.

“In this view of the case it is unnecessary to determine whether the instructions were erroneous or whether the verdict was excessive. Upon the entire record there was a complete absence of probative facts to support the essential conclusion that the railroad had notice, actual or constructive, of the presence of the oil, and, therefore, the trial court erred in refusing to direct a verdict for the defendant. Accordingly, the judgment is reversed.”

The duty of the railroad in this instance was no different than that of any other owner or proprietor of premises who has a duty of maintaining the premises in a reasonably safe condition. As stated by the trial

court (R. 655), there is no reason for applying a different rule than that that would be applied to the owner of a store where the patron used its aisles as a brakeman would use the space between the railroad tracks in the performance of his duties. Thus, the decisions of the Washington State Supreme Court on the question of negligence and notice in connection with the duty of a proprietor of a business providing a reasonably safe place for his patrons to travel while upon his establishment became pertinent in this case. In *Mathis v. H. S. Kress Co.*, 38 Wn.(2d) 845, 232 P.(2d) 921, the court held that the very fact that there was liquid on the floor which caused the patron to slip and fall did not prove negligence of the owner, since there was an absence of proof as to how long it was there and how it got there. The court stated that where negligence is predicated upon the failure to keep one's premises in a reasonably safe condition it must be shown that either the condition had been brought to the owner's attention or had existed for such a time as to have afforded him sufficient opportunity in the exercise of reasonable care to become cognizant of and to have removed the danger.

The appellant attempts to avoid the inescapable conclusion that the appellee had no notice of the existence of this wire, by contending that the doctrine of *res ipsa loquitur* applies. In essence he contends that merely because the appellant was employed in the appellee's train yards at the time of the accident, that the doctrine automatically applies. He asserts that because the appellant testified the wire was coiled, such testimony constitutes evidence that the wire had been placed or left

there by the appellee's employees. He further asserts that because the wire was rusted, that amounts to evidence that the wire had been there for some time.

This completely disregards the obvious fact that wire, especially baling wire, has a natural tendency to coil. The mere fact that it was found coiled is not evidence of anything. It is as equally probable that it came coiled from the factory as to assume that it was coiled by an employee of the appellee. Certainly it is not evidence that it had been placed or left at this particular spot by an employee of the appellee. As stated by the trial court (R. 659), this baling wire could have been there without negligence on the part of the railroad. It could just as well have fallen from another car as having been placed or left there (R. 661). As a matter of fact, the inference if any to be drawn from the fact that it was there, would be that it would be more likely that it had fallen off another car, because no one had ever seen any wire laying between the tracks in the area where this accident occurred. Surely it would be sheer speculation to conclude that because wire is coiled where it is found, that it was necessarily placed or left at that point by human hands.

Likewise, it is sheer speculation to conclude that because wire appears rusty, it must have been at the particular location where it is found for several days. Again, as the trial court pointed out, it could just as well have rusted on a flat car or on any other object on which it may have been used by someone other than the appellee (R. 661). If it had been exposed to the air and the elements for a comparatively short time, it would rust. When this piece of wire became rusted, no-

body knows. Surely more than the mere discovery of a piece of rusted wire is required to prove actionable negligence, even under the most liberal interpretation of the Federal Employers' Liability Act. And this is especially so, when the evidence and reasonable inferences to be drawn therefrom is to the effect that this type of wire was not used by railroad men at this location in the yards in connection with any work that they might do; and the further fact that no one had ever seen or found any such wire in this part of the yards.

III.

The doctrine of *res ipsa loquitur* is not applicable.

In order for the doctrine of *res ipsa loquitur* to apply, the following elements must be present:

1. The accident is of such a nature that it would normally not happen if due care is used. *Delaware Dredging Co. v. Graham*, 43 F.(2d) 852.

2. The accident is of such a nature that according to ordinary human experience it could not have happened without negligence. *Yazoo & M. V. R. Co. v. Skaggs*, 181 Miss. 150, 179 So. 274.

3. The thing that causes the injury is under the exclusive control and management of the defendant at the time the accident occurs. *Jesionowski v. Boston & Maine Railroad*, 329 U.S. 452, 67 S. Ct. 401, 91 L.ed. 416.

The doctrine applies only where on proof of the occurrence and the injury, the existence of negligence or fault is the more reasonable probability, and must not be allowed to prevail where, on proof of the occurrence

without more, the matter rests only in conjecture. *Dail v. Taylor*, 151 N.C. 284, 66 S.E. 135. Thus, the mere happening of an accident and injury to an employee does not justify the inference of negligence, and the doctrine of *res ipsa loquitur* does not apply. *Foquet v. New York Central & H. R. R. Co.*, 53 Misc. 121, 103 N.Y. Supp. 1105.

Applying these tenents to the facts in the instant case, it would seem obvious that the doctrine cannot apply. Certainly this accident could have happened without negligence on the part of anyone. The facts do not "speak for themselves," as has been so often said in the case of *res ipsa loquitur*. There was nothing extraordinary about this accident. As the trial court held, this coil of wire could as easily have been there as a result of falling off a car as it could have by being placed there by an employee of the railroad. In fact, from the testimony, the great likelihood is that it was not placed there by any employee, since no such wire was used by any such employee in that area in connection with their railroad work.

The appellant, of course, would not argue that the exercise of due care in the inspection and cleaning of the area between the tracks by the railroad would completely prevent the possibility of this wire being there at the time the appellant fell. Therefore, the doctrine can be of no help to him in furnishing otherwise lack of proof as to how long the wire had been there. The respondent could have exercised even more than ordinary care in the inspection and cleaning of its yards and yet it would be entirely possible for the wire to have been there at the time that appellant fell.

Even more important, is the fact that there is no proof whatsoever that the thing or agency which caused the appellant to fall was under the exclusive control and management of the respondent, at the time of the accident. Thus, one of the most important elements required before the doctrine can even be applicable, is missing in this case. Evidence as to where this baling wire came from, or how it got there, or how long it had been there, is completely lacking. *Res ipsa loquitur* cannot be used to supply the missing evidence to create the requirements necessary before the doctrine becomes applicable. As said in *Batson v. Western Union Telegraph Co.*, 75 F.(2d) 154, "*res ipsa loquitur*" applies only when the thing shown speaks of negligence on the part of the defendant, not merely of the occurrence of an accident.

In *Martin v. Southern Pac. Co.*, 46 F.Supp. 957, the defendant had made a reasonable inspection of a freight car that did not belong to it before delivery of the car to the consignee. At the time of the accident the railroad was not in exclusive control thereof. Accordingly, the court held that the doctrine of *res ipsa loquitur* was not applicable. The court held that it was just as reasonable to assume from the evidence that the accident might have been caused by third parties over whom the railroad had no control, as it was to assume that it was caused by negligence on the railroad's part.

In *McPherson v. Oregon Trunk Ry.*, *supra*, a night watchman employed to patrol the tracks of the railroad constructed through a cut in solid rock, was injured by falling rock. He alleged negligence on the part of railroad by reason of the rock falling. He also alleged neg-

ligence by reason of the presence of spikes protruding from the ties, which he claimed impeded him from running to escape the falling rock. The court held that the doctrine of *res ipsa loquitur* was not applicable. It said the cause of the rock falling rested on sheer speculation. It also held that there was no evidence that the railroad had, prior to the injury, notice of the presence of the spikes which allegedly protruded from the ties and impeded the watchman's running to escape the falling rock.

In *Oelschlaeger v. Hahne & Co.* (S.Ct. N.J.) 66 A. (2d) 861, a customer tripped and fell over a stool, placed or left by a counter of a department store. The only evidence was that the stool was used by clerks in the shoe department. How it got by the counter and how long it had been there was not shown. The court held that the doctrine of *res ipsa loquitur* was inapplicable to raise an inference of negligence. It held in effect that if it is just as reasonable to infer that the stool got there by other means than the act of one of the store employees, then the doctrine cannot be invoked.

The *res ipsa loquitur* doctrine does not raise a presumption of negligence, but merely warrants an inference thereof, where the accident would not likely have happened but for negligence. *Fick v. Pilsener Brewing Co.*, 151 Ohio S.T. 555, 86 N.E.(2d) 616. Thus, where the accident could have happened without negligence, there first must be some basis of negligence before the inference is warranted.

As said in *Levine v. Union & New Haven Trust Co.*, 127 Conn. 435, 17 A.(2d) 501, the *res ipsa loquitur* doctrine has no evidential force, does not shift the burden

of proof, and does not give rise to a presumption or compel the trier of the facts to draw an inference of negligence.

And even where the doctrine is applicable, it cannot be substituted for evidence of negligence. As succinctly stated by the Supreme Court of the United States in *Sweeney v. Erving*, 228 U.S. 233, 33 S.Ct. 416, 57 L.ed. 815 (and cited with approval in the recent case of *Jesionowski v. Boston & Maine Railroad, supra*):

“*Res ipsa loquitur* means that the facts of the occurrence warrant the inference of negligence, not that they compel such an inference; that they furnish circumstantial evidence of negligence where direct evidence of it may be lacking, but it is evidence to be weighed, not necessarily to be accepted as sufficient; that they call for explanation or rebuttal, not necessarily that they require it; that they make a case to be decided by the jury, not that they forestall the verdict.”

Thus, under the most favorable consideration of the appellant's argument; *i.e.*, that the doctrine of *res ipsa loquitur* applies in this case, no court has gone as far as he would contend. That is, merely because the doctrine might apply, that the trier of the facts is then compelled to find for plaintiff. He would simply brush aside the evidence and findings of the trier of the facts and insist that because the doctrine of *res ipsa loquitur* might raise an inference, that the court is then compelled to find the appellee negligent and enter a judgment for the appellant.

To sustain his position that the doctrine of *res ipsa loquitur* must be applied, appellant asserts on page 14

of his brief (without reference to the record) that the wire on which appellant tripped was similar in appearance to that used by appellee on its trains. The record will not support the contention that a wire similar in appearance to that which the appellant described was even used by the railroad. Appellant himself described this wire as "baling wire." The evidence was that baling wire was foreign to the railroad (R. 387), that it was never used (R. 394, 395).

In an effort to discover some wire used by the railroad, testimony was elicited that two other types of wire, not at all like baling wire, were sometimes used. Neither of these wires, however, were ever used on the train yard tracks or in the area where appellant fell, or ever used in connection with any work that might be performed in that area. One of the wires, stovepipe wire, is a much thinner wire than baling wire (R. 399). The evidence was that it was never used in this area, but only out on the line in the case of emergency or out on the repair (rip) track or the shop (R. 367, 368, 403).

The other wire, No. 9 wire, which is much heavier than baling wire (R. 395) was only used in connection with stakes on loads of poles. This use was not made on or near the train yard tracks, but out on the repair (rip) tracks (R. 413). Thus, neither of these wires were either similar to the wire which the appellant himself described, nor were they a type of wire that was apt to be found along the train yard tracks since no use of them was made in that area.

Based upon the above unfounded assertion, together with the fact that the wire was described as rusty and

that other debris was seen to be removed from the Hill-yard Yards in general, several months after the accident, appellant maintains that the evidence would justify the application of the doctrine.

Without any more, the appellant then assumes that the appellee was negligent and insists that it was then required to produce evidence to explain its apparent negligence. In so assuming, of course, he is assuming another false premises, *i.e.*, that the accident could not have happened, but for the negligence of the appellee. Instead, even if we were to assume that the doctrine was applicable under those facts, it would only raise an inference as to the possible notice which the railway company might have had of the existence of this wire. Neither the trial court nor this court would be compelled to infer notice in the face of testimony that this area was not only inspected and cleaned on the morning of the accident (R. 350, 368), but that it was found to be clean on the afternoon of the accident (R. 390, 391, 410), and that no one testified that thereafter there was any evidence of any wire in this area which the appellee knew of or should have known of by reasonable inspection and maintenance.

Appellant further assumes that it is reasonable to infer negligence in the manner in which the inspection and cleaning was performed. He contends that the appellee failed to prove that the inspections were performed with due care. Again, he prefers to disregard or overlook the evidence that not only was no wire found in this area (R. 368, 407), but that after the area had been inspected and cleaned on the day of the accident it was found to be clean on the same afternoon of the

day that it had been inspected and cleaned (R. 390, 391, 410). What better evidence that due care was used in the performance of these duties than testimony that after they had been performed the area was clean and free of *any* material, not only wire (R. 410). If further evidence were needed, the testimony of Witness James that this particular area is generally very clean (R. 407) should suffice. Surely, an inference that due care was not exercised need not nor cannot be drawn from this evidence.

Notwithstanding all this, appellant contends in his brief that the great weight of the evidence supports the conclusion that the appellee was negligent in permitting a coil of wire to *fall* to a pathway in its yard and in failing to exercise due care in inspecting and cleaning the pathway. By that very statement appellant acknowledges a change in his position from that on which the cause of action was based; *i.e.*, the complaint, and in fact the evidence at the trial of the case. Appellant did not rely on general negligence, but specifically pleaded and argued at the time of trial that the appellee was negligent in (a) failing to properly and frequently inspect its yards and to keep the same in a neat condition; (b) failing to keep its footpath clear of wire and other debris; (c) negligently *placing* the coil of wire on said footpath and permitting the same to be *placed* and remain there for a sufficient length of time for the appellee in the exercise of due care to have discovered the same and remove it; and (d) in failing to warn the appellant to be on the lookout for said wire. It has long been recognized that where the plaintiff's evidence or basis of negligence

arises out of specific acts of negligence, then the doctrine of *res ipsa loquitur* is not applicable.

Palmer v. Brooks, 350 Mo. 1055, 169 S.W.(2d) 906;

Winslow v. Ohio Bus Line Co., 148 Ohio S.T. 101, 73 N.E.(2d) 504;

Van Houten v. Kansas City Public Service Co., 233 Mo. App. 423, 122 S.W.(2d) 868;

Sims v. Dallas Ry. & Terminal Co. (Tex. App.), 135 S.W.(2d) 142;

Bewley v. Western Creameries, Inc., 177 Okl. 132, 57 P.(2d) 859.

As stated in *Harke v. Haase*, 335 Mo. 1104, 75 S.W. (2d) 1001, the principal difference between a *res ipsa loquitur* case and a specific negligence case is that in the former the ultimate fact of some kind of negligence is inferred without any evidential fact except unusual occurrence itself, while in the latter there must be evidential facts sufficient to show some negligent acts or omissions which were the proximate cause of the occurrence.

IV.


Criticism of Cases Cited by Appellant

Whatever may have been the law of England, as enunciated in *Byrne v. Boadle*, 2 H. & C. 722, 159 Eng. Repr. 299, in 1863, the law pertaining to the doctrine of *res ipsa loquitur* which this court will apply is based upon the decisions of State and Federal courts in applying said doctrine in negligence cases.

Rogers v. Mo. Pac. R. Co., 352 U.S. 500, and *Webb v. Illinois Central R. Co.*, 352 U.S. 512, were not concerned with the doctrine of *res ipsa loquitur*. Appellant acknowledges that fact, but cites those cases as indicative of the liberal policy of the Supreme Court in determining what evidence will be sufficient evidence of negligence to submit a case to the jury. Of course that is not our problem here. This case was submitted to the trier of the facts and was determined by the trier of the facts at the end of the entire case. Nor did those decisions change the law of negligence, for at the same time the Supreme Court decided *Herdman v. Pennsylvania R. Co.*, 352 U.S., 77 S.Ct. 455, 1 L.ed (2d) 508, where it affirmed a directed verdict for the railroad, holding that a jury question of negligence was not presented by the proofs. More significant, the court also held in the *Herdman* case that *res ipsa loquitur* was not applicable on the ground that the proof did not meet the test laid down by the Supreme Court in the *Jesionowski* case, wherein it held *that the occurrence had to be extraordinary, so that when it occurs, a jury may fairly find that it occurred as a result of negligence.*

The facts in *Baltimore & O. R. Co. v. Flechtner*, 300 Fed. 318, certiorari denied 266 U.S. 613, upon which appellant heavily relies, are somewhat different from those in the instant case. There the barrel hoop over which plaintiff fell came from a keg of railroad spikes. It was apparently further shown that there was little or any likelihood that the hoop would have been where it was except by reason of having been left or placed there by railroad employees. No evidence of

inspection was indicated in the opinion. Even so, all that the court said was that these were questions for the trier of the facts. The court did not say that said facts constituted negligence or conclusively showed that the plaintiff was entitled to recover.

The *Kast* case is even more distinguishable (*Baltimore & O. R. Co. v. Kast*, 299 F.(2d) 419, certiorari denied 266 U.S. 613). There the socket wrench which was lying in the path was the kind of tool that was used by the employees in their work in the area in which the plaintiff was injured. The court further went on to find that it was not the kind of a tool that would normally be transported. The court further found that it was not equally logical to assume that the wrench fell on the path from a conveyance carrying tools, without there being any negligence accompanying such fall. This was for the reason that there was no evidence that tools were trucked along this path, but presumably were carried by the workmen. Even so, the court said, if it had been trucked it would be difficult to see how, without negligence, either in the loading or the hauling, a tool of this size would fall off unobserved. 

The fact that the wrench was used only by the machinist, who worked in this area, and thus was within the exclusive control of the railroad, together with the improbability of it having fallen in this location, led the court in the *Kast* case to allow the case to be *submitted to the jury* on the basis of *res ipsa loquitur*. In doing so, however, it reiterated the rule that a mere conjecture, standing upon a basis of uncertain inference, does not make substantial evidence. Such a case

lacks both the quantitative and qualitative essential minimum. Citing *Copeland v. Hines*, 269 Fed. 361.

Nor can the appellant find any comfort in *Waller v. Southern Pacific Terminal Co.*, 178 Or. 274, 166 P.(2d) 488. In that case the court reversed a verdict for the plaintiff on the ground that there was no substantial evidence of negligence on the part of the defendant. The facts and testimony were quite similar to the case at bar. The Supreme Court of Oregon extensively reviewed the evidence concerning the alleged acts of negligence and the matter of inspection and cleaning of the yard. It found, as the trial court did here, that the area in which the plaintiff fell had been inspected and cleaned on the very day of the accident and had been found to be clean after said inspection. As here, it found that there was no evidence as to how the splinter of wood got there, where it came from, or how long it had been there. It further noted that from the evidence, it may have fallen from the train which the plaintiff was boarding. It found that there was not a scintilla of evidence that the defendant ever placed or caused to fall into its yard any sticks or debris of the type over which the plaintiff fell.

Based upon this evidence the court found that even considering the evidence in a light most favorable to the plaintiff, there was no substantial evidence of negligence. On the question of inferences it said at page 496:

“As we have said, in determining whether there was substantial evidence of negligence proximately causing plaintiff’s injury, it is our duty to con-

sider the testimony in the light most favorable to the plaintiff; but it is also our duty to give consideration to evidence adverse to the plaintiff's contention where it is wholly undisputed and uncontradicted and relates to matters of fact as distinguished from mere inferences. Where a plaintiff's case is based upon an inference or inferences only, that case must fail upon proof of undisputed facts inconsistent with such inferences. *Pennsylvania Railroad Co. v. Chamberlain*, 288 U.S. 333, 53 S.Ct. 391, 77 L.ed. 819."

It also held at page 498, that the general rule concerning the duty owed by the owner of land to persons employed or invited thereon applies in this type of case. It said:

"The duty of the defendant under the F.E.L.A. is the same as the duty of a proprietor to invited guests as far as the rule now to be considered is concerned."

After citing Oregon cases on the question of the duty of a proprietor, it also held at page 499 as follows:

"Since there is no evidence that the defendant caused any dangerous condition on any part of the 'O' yard, it can be held liable, if at all, only upon the theory that it negligently failed to remove an object, or objects, deposited there by others. Assuming that the plaintiff stepped on a stick, there is no evidence that the defendant knew of its existence, nor is the defendant chargeable with constructive notice that any stick was on the ground at the point where plaintiff slipped for there is no

evidence as to how long the stick, if any, had been there.”

In the *Waller* case, as in the instant case, there was evidence that other railroads used the yards. (Here, the Spokane, Portland & Seattle Railway used the Hillyard Yards (R. 179)). There, the Oregon-Washington Railroad & Navigation Company also used the yards.

As to distinguishing the *Flechnner* case (*Baltimore & O. R. Co. v. Flechnner*, 300 Fed. 318), the Oregon court merely noted that the court in the *Flechnner* case held that the rusty condition of the hoop justified submission of the case to the jury, on the question of constructive notice. This was because, the court said, the evidence tended to indicate that the defendant railroad, and not any other third person, had placed the hoop between the tracks, where it had also noted that hoops such as this were found on kegs of railroad spikes, which the railroad admittedly used.

A close reading of the cases cited by appellant in his opening brief on page 12, fails to disclose any mention whatsoever of the doctrine of *res ipsa loquitur*, with the exception of the case of *Howard v. Pennsylvania R. Co.*, 43 Ohio App. 96, 182 N.E. 663, which will be discussed hereafter. All that the other cases merely stand for is, the proposition that the question of negligence was for the jury. As to the thing over which the plaintiffs in those cases tripped, the evidence in each case either indicated that it was an item regularly used by the railroad in that area, so as to automatically impute notice to the railroad, or was in such a condition that it obviously had been there for some time.

In the *Howard* case, where it was held that the doctrine of *res ipsa loquitur* applied, the plaintiff was injured when the speeder upon which he was riding was derailed due to striking a jack block on the rail. The court pointed out that there was evidence that a jack block had been used by the railroad on this very track a short time before the accident, and that jack blocks were regularly used by the railroad in this area. Thus, the factual situation on notice was completely different.

The cases which appellant cites to support the use of the doctrine of *res ipsa loquitur* have not applied that doctrine to furnish the facts upon which the negligence itself must be predicated. In *McPherson v. Oregon Trunk Ry.*, *supra*, the court stating that the doctrine had no application under the facts of that case, quoted from *Ragolasky v. Nurenberg*, 211 Mass. 575, 98 N.E. 594, where the court said:

“We have here the mere occurrence of an accident. To infer from that alone that it was caused by the negligence of the defendants would be to assume the very issue which the plaintiff is obliged to prove. This is not a case of *res ipsa loquitur*, where we can say that in the ordinary course of things such an accident could not happen unless from careless construction, inspection or use attributable to the employer.” (Emphasis supplied)

Likewise, in *See v. Chicago B. & Q. R. Co.* (Mo. App.) 228 S.W. 518, the court stated that the doctrine of *res ipsa loquitur* did not apply because the circumstances and things that happened in no wise excluded all defensive inferences. In that case a night watchman

employed to patrol defendant's tracks which were constructed through a cut of solid rock, was struck and injured by the falling of a rock from the side of a deep cut, and there was no evidence as to the cause of the fall of the rock.

In *O'Mara v. Pennsylvania R. Co.*, 95 F.(2d) 762, the court held that the doctrine of *res ipsa loquitur* was not applicable. The court said that while the bolt over which the plaintiff fell or tripped was of a type used by the railroad on the structure of cars, there was no evidence as to how the bolt came to be upon the platform, where plaintiff was walking.

CONCLUSION

The trial court heard the oral evidence of both parties in this action. Having weighed and considered the same insofar as it was necessary to do so to determine whether or not the plaintiff could prevail, the appellate court will not set aside its findings unless they are clearly erroneous or it is found that the trial court erred as a matter of law. Based upon the record in this case there is clearly evidence to support the trial court's findings and conclusions. The judgment entered as a result of said findings and conclusions cannot be set aside merely because the evidence might have been sufficient to submit the case to a jury, if there had been a jury. To hold otherwise would render meaningless and useless the function of the trial judge as a trier of the facts. The trial court's desire to console the appellant and his attorney by indicating to them that he would have taken this case from the jury had there been

one, does not change the fact that no jury was requested and the case was submitted to the court sitting as the trier of the facts. That being so, on appeal appellant is bound by the rules and decisions of the Federal courts pertaining to such appeals.

Based upon the rules and decisions of the Federal courts, the only question before this court is as stated in the appellant's own concise statement of points on appeal, *i.e.*:

“Whether the court erred in failing to find in favor of the plaintiff and against the defendant on the basis that the evidence conclusively established that defendant was negligent and liable for plaintiff's injuries.”

On that issue the trial court clearly did not err. Therefore, the appellee is entitled to an affirmance of the judgment.

Respectfully submitted,

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